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**LAW, FOREIGN DIRECT INVESTMENT
AND ECONOMIC DEVELOPMENT IN
TAIWAN**

by

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LL.M. (UNIVERSITY OF WARWICK, ENGLAND)

**A THESIS SUBMITTED IN FULFILMENT OF THE DEGREE
OF DOCTOR OF PHILOSOPHY REQUIREMENT OF THE
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COVENTRY, ENGLAND**

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**TO MY MOTHER AND IN MEMORY OF MY
FATHER**

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DECLARATION

I, the undersigned, **MING-YU HO**, hereby declare that the work contained in this thesis is my own original work and where other sources have been consulted, the same have been duly acknowledged.

It is being submitted for the degree of Doctor of Philosophy (Ph.D.) at the University of Warwick in Coventry, England. It has not been submitted before for any degree of examination in any other University.

SIGNATURE

DATE

ABBREVIATIONS

<i>A.J.C.L.</i>	American Journal of Comparative Law
<i>A.J.I.L.</i>	American Journal of International Law
<i>A.L.R.</i>	Australian Law Reports
AID	Agency for International Development (United States)
AIT	American Institute in Taiwan
All E.R.	All English Report
<i>Annual Digest</i>	Annual Digest and Reports of Public International Law Cases
APEC	Atlantic Provinces Economic Council
<i>AWSJ</i>	Asian Wall Street Journal, Hong Kong
<i>B.Y.B.I.L.</i>	British Year Book of International Law
BIER	Business Environment Risk Intelligence (United States)
BOT	Bank of Taiwan
<i>C.M.L.R.</i>	Common Market Law Review
CBC	Central Bank of China (ROC)
CCP	Chinese Communist Party
<i>CDN</i>	Central Daily News (overseas edition), Taipei
CEPD	Council for Economic Planning and Development (ROC)
CIECD	Council of International Economic Cooperation and Development
CIER	Chung-hua Institution of Economic Research (ROC)
Cmd. and Cmnd.	Command Papers (British)
<i>Co Rep</i>	Coke's Report
CUSA	Council for US Aid (ROC)

DGBAS	Directorate-General of Budgets, Accounts and Statistics (ROC)
DGC	Directorate General of Customs (ROC)
DLF	Development Loan Fund
DRAM	Dynamic Random Access Memory
DSMOF	Department of Statistics, Ministry of Finance (ROC)
<i>E.C.L.R.</i>	European Community Law Review
ECHR	European Court of Human Rights
EEC	European Economic Community
EPC	Economic Planning Council (ROC)
EPZs	Export Processing Zones (ROC)
ERSEI	Enforcement Rules of Statute for Encouragement of Investment (ROC)
ERSO	Electronics Research Service Organisation (ROC)
ESB	Economic Stabilisation Board (ROC)
<i>FCJ</i>	Free China Journal, Taipei
FCO	Foreign and Commonwealth Office (Great Britain)
<i>FCW</i>	Free China Weekly, Taipei
<i>FEER</i>	Far Eastern Economic Review, Hong Kong
G.A.	General Assembly of the United Nations
GATT	General Agreement on Tariffs and Trade
GBFCO	Foreign and Commonwealth Office (Great Britain)
GDP	Gross Domestic Product
GEA	General Economic Aid
GIO	Government Information Office (ROC)
GNP	Gross National Product
<i>H.I.L.J.</i>	Harvard International Law Journal

<i>H.L.R.</i>	Harvard Law Review
<i>Hague Recueil</i>	Hague Recueil des Cours
HMSO	Her (His) Majesty's Stationery Office (Great Britain)
<i>I.C.J. Reports</i>	International Court of Justice, Reports of Judgements, Advisory Opinions and Orders
<i>I.C.L.Q.</i>	International and Comparative Law Quarterly
<i>I.L.M.</i>	International Legal Materials
<i>I.L.R.</i>	International Law Reports (Continuation of the <i>Annual Digest</i>)
IBRD	International Bank for Reconstruction and Development
IBRD	International Bank for Reconstruction and Development
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
<i>ICSID Rev.</i>	ICSID Review - Foreign Investment Law Journal
IDC	Industrial Development Commission (ROC)
IDIC	Industrial Development and Investment Centre (ROC)
IGC	Inspectorate General of Customs (ROC)
IGOs	International Government Organisations
IMF	International Monetary Fund
<i>Int Conc</i>	International Conciliation
<i>Iran-U.S.C.T.R.</i>	Iran-United States Claims Tribunal Reports
ITIR	Industrial Technology and Research Institute (ROC)
<i>J.P.L.</i>	Journal of Public Law
<i>J.W.T.L.</i>	Journal of World Trade Law
JCRR	Sino-American Joint Commission on Rural Reconstruction
<i>K.B.</i>	King's Bench Reports

KEPZ	EPZ in Kaohsiung (ROC)
KMT	Kuomintang (The Chinese Nationalist Party)
<i>L.J.R.</i>	The Law Journal Reports
<i>L.Q.R.</i>	Law Quarterly Review
<i>L.T.R.</i>	The Law Times Reports
LDCs	Less-Developed Countries
MITI	Ministry of International Trade and Investment (Japan)
MNEs	Multinational Enterprises
MOEA	Ministry of Economic Affairs (ROC)
MOF	Ministry of Finance (ROC)
NEPZ	EPZ in Nantze (ROC)
<i>Neth.I.L. Rev.</i>	Netherlands International Law Review
NIC	Newly Industrialised Economy
NIE	Newly Industrialised Country
NT\$	New Taiwan Dollars
<i>NYT</i>	New York Times
OECD	Organisation for Economic Cooperation and Development
<i>P.C.I.J.</i>	Publications of the Permanent Court of International Justice Series A (1922-1930)-- Collection of Judgements B (1922-1930)-- Collection of Advisory Opinions A/B (since 1931)-- Cumulative Collection of Judgments, Order, and Advisory Opinions C (since 1922)-- Acts and Documents relating to Judgement and Advisory Opinions D (since 1922)-- Collection of Texts governing the Jurisdiction of the Court E (since 1925)-- Annual Reports F -- General Index
PBAS	Provincial Bureau of Accounting and Statistics (ROC)
PBEC	Pacific Basin Economic Council
PCA	Permanent Court of Arbitration

PCIJ	Permanent Court of International Justice
PDAF	Provincial Department of Agriculture and Forestry (ROC)
PECC	Pacific Economic Co-operation Council
PRC	People's Republic of China
Pub. L	Public Law (United States)
<i>Q.B.D.</i>	The Law Reports: Queen's Bench Division
R&D	Research and Development
<i>R.I.A.A.</i>	United Nations Reports of International Arbitral Awards
RGEMBW	Regulations Governing the Establishment and Management of Bonded Warehouse (ROC)
RGLPFLTP	Regulation Governing the Lease of Private Farm Land in Taiwan Province (ROC)
ROC	Republic of China
<i>S.L.R.</i>	Stanford Law Review
<i>S.T.</i>	Cobbett's Complete Collection of State Trials
SAFE	Statute for the Administration of Foreign Exchange (ROC)
SEAASIP	Statute for the Establishment and Administration of A Science-based Industrial Park (ROC)
SEC	Securities and Exchange Commission (ROC)
SEI	Statute for Encouragement of Investment (ROC)
SIFN	Statute for Investment by Foreign Nationals (ROC)
SIOC	Statute for Investment by Overseas Chinese (ROC)
SIPA	Science-based Industrial Park Administration (ROC)
SUI	Statute for Upgrading Industries (ROC)
<i>SUPP.</i>	Supplement
TBMOC	Tourism Bureau, Ministry of Communications (ROC)
TEPZ	EPZ in Taichung (ROC)
<i>Texas ILF</i>	Texas International Law Forum

TFSM	Taiwan Financial Statistics Monthly
TIER	Taiwan Institute of Economic Research
TPAFD	Taiwan Provincial Agriculture and Forestry Department
TPB	Taiwan Production Board
TRFS	Treaties between the ROC and Foreign States
TSDB	Taiwan Statistical Data Book
TSMC	Taiwan Semiconductor Manufacturing Corporation
TVA	Taiwan Visitors' Association (ROC)
U.K.T.S.	United Kingdom Treaty Series (Since 1892), London: HMSO
U.N.I.L.C.	United Nations, International Law Commission
U.N.T.S.	United Nations, Treaty Series
<i>U.N.Y.B.I.L.C.</i>	United Nations, Yearbook of the International Law Commission
U.S.C.	United States Code
U.S.C.A	United States Code Annotated
UN Juridical YB	United Nations Juridical Year Book
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations, Industrial Development Organisation
US	United States
<i>Virginia ILJ</i>	Virginia Journal of International Law
<i>W.C.R.</i>	The World Court Reports
WTO	World Trade Organisation
<i>Y.B.U.N.</i>	Yearbook of the United Nations
<i>Y.C.A.</i>	Yearbook of Commercial Arbitration
<i>Y.L.J.</i>	Yale Law Journal

GLOSSARY OF CHINESE AND JAPANESE WORDS

Anping	安平
Amoy	廈門
Bakufu (J)	幕府
Ch'en Ch'eng	陳誠
Ch'en Yi	陳儀
<i>ch'iao-wai chih-chieh-t'ou-tzu'</i>	僑外直接投資
Ch'üan-chou	泉州
Cheng Ch'eng-kung	鄭成功
Cheng Chi-lung	鄭芝龍
Cheng Ho	鄭和
Cheng K'o-shuang	鄭克塽
<i>chia</i>	甲
Chiang Ching-kuo	蔣經國
Chiang Kai-shek	蔣介石
<i>chieh-chih tzu-pen</i>	節制資本
<i>chieh-yen ling</i>	戒嚴令
<i>chin-yüan</i>	金元
<i>ching-pei-tsung-pu</i>	警備總部
Cho-shui	濁水
Chung-jung Yin	尹仲容
Chungking	重慶
<i>f'a-pi</i>	法幣
<i>Fa</i>	法

<i>fu-chou-hua</i>	福州話
Fukien	福建
<i>fukoku kyoehei</i> (J)	富國強兵
<i>hai-chin jen-t'sa</i>	海禁政策
Han Dynasty	漢朝
<i>Han-jen</i>	漢人
<i>hoko</i> (J)	保甲
<i>hsien</i>	縣
Hsin-chu	新竹
<i>hsing t'ai-pi</i>	新台幣
Huai-hai	淮海
<i>K'o jen</i>	客人
<i>kaisha</i> (J)	會社
Kaohsiung	高雄
Keelung	基隆
Kinmen (Quemoy)	金門
<i>Kung-ssu Lü</i>	公司律
<i>kuo-an-hui</i>	國安會
<i>kuo-yü</i>	國語
Kuomintang	國民黨
Kwangtung	廣東
Lee Teng-hui	李登輝
<i>Li</i>	理
Liaodong	遼東
Liu Ming-ch'uan	劉銘傳
<i>luan-shih yung chung-tien</i>	亂世用重典
Mao Tse-tung	毛澤東

Mastu	馬祖
Meiji (J)	明治
<i>Min-ch'uan</i>	民權
<i>Min-nan-hua</i>	閩南話
<i>Min-sheng</i>	民生
<i>Min-tsu</i>	民族
<i>naichijin</i> (J)	內地人
Nantez	楠梓
P'eng Ming-min	彭明敏
<i>pao-chia</i>	保甲
<i>pen-sheng-jen</i>	本省人
Penghu	澎湖
Sakoku (J)	鎖國
<i>San Min Chu I</i>	三民主義
<i>Shang Jen Tung Lü</i>	商人通律
Shimonoseki (J)	下關
<i>sogo shosha</i> (J)	總合商社
<i>Sotokufu</i> (J)	總督府
Sun Yet-sen	孫逸仙
Szechuan	四川
<i>t'ien-hsia wei-kung</i>	天下爲公
<i>ta-t'ung</i>	大同
Taichung	台中
Taihoku (J)	台北
Tainan	台南
Taiwan currency (<i>t'ai-pi</i>)	台幣
Tamshui	淡水

<i>Tang-shih</i>	唐詩
Tanshui	淡水
Tientsin	天津
Tokugawa (J)	德川
<i>tsung-ts'ai</i>	總裁
<i>wai-sheng-jen</i>	外省人
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<i>Yuan-chu-min</i>	原住民

SUMMARY

This research looks at the legal regime governing foreign direct investment (FDI) in Taiwan, and at the interaction between the Government's economic policies, legal reform and FDI in the economic development of Taiwan. The research for this thesis is focused on the period of 1945 to the present; however, a study of the pre-1945 period is provided as a basis for analysing the post-1945 developments. There are three principal aims of this thesis. First, the thesis is designed to illustrate how the economic success of Taiwan challenges traditional views put forward in development theories and in law and development theories, in particular. Secondly, the thesis considers the role of law in the development process. By examining the evolution and operation of the FDI legal regime in Taiwan in its economic, social, political and historical context, this research suggests that the role of law is as a 'doorkeeper' for a country's development. If consistent with a public-interest-oriented economic policy, an appropriate and well-considered legal regime can help a country's development without risking its economic sovereignty. Finally, this thesis examines Taiwan's current FDI regime for its appropriateness. Using international law as a reference-point, a detailed analysis is made of Taiwan's current FDI laws. The thesis suggests that certain of these laws are out of date and that further legal reform is required.

The thesis concludes by slightly modifying the developmental model for law and FDI which is put forward in Chapter 1, in order to emphasise the important role of government economic policy in Taiwan's development. It is submitted that the Government's choice of development strategy in each of Taiwan's different development phases has been crucial to Taiwan's success. The thesis also concludes that an appropriate legal regime remains important for a country's development regardless of its development status.

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Chapter 1

Introduction

1.1 Scope of the Research and Reasons for Undertaking it

This research looks at the legal regime governing foreign direct investment (FDI) in Taiwan, and at the interaction between the Government's economic policies, legal reform, and FDI in the economic development of Taiwan. Although the main aim of this research is to discuss the ROC's laws, economic policies and strategy regarding FDI after 1945 (when the ROC government moved to Taiwan from the mainland), the thesis includes a study of Taiwan's pre-1945 economic development, which is necessary as it provides a basis for understanding the overall development process. The aims of this study are threefold. First, traditionally development theory makes certain assumptions about the difficulties faced by developing countries in pulling themselves out of subjugation by an oppressive international economic system, and the exploitation role of multinational enterprises through FDI. However, I shall seek to challenge these assumptions in the context of Taiwan, and to consider how a State can use law to invite and control FDI, without risking its sovereignty, to facilitate its economic development. As part of doing so, I propose a development model, which will be discussed in the next section, to explain the relationship between FDI, law and economic development. Secondly, this research considers the role of law in encouraging and controlling FDI in Taiwan by examining the operation of the legal regime in its appropriate economic, social, political, and historical context. Finally, the current legal regime governing FDI in Taiwan will be analysed and assessed with regard to possible legal reform in the future.

1.1.1 Why is this Research Important?

The comprehensive study of FDI is one of those socio-scientific topics which involves a study of complex historical, economical, political, social and legal issues. But research to date has tended to concentrate on only one or two of these factors. Some social scientists, such as Bierman (1984), Froot (1993), and Carr (1969), seek to solve the investors' dilemma of maximizing profits and minimizing the investment risk by using economic methods. Others, such as Chan (1995) and Parry (1980), look at the issue from the host countries' view-point and try to examine the impact of FDI on the host countries' economies by applying political economy theories. There are, of course, legal scholars such as Sornarajah (1994) and Silk (1994), who examine the question of how national and international law regulates the problems raised by FDI at various levels.

There are probably three major reasons why FDI remains one of the most controversial subjects in the development literature. First, it is a topic that is frequently raised in political debate between developed and developing countries, where its treatment is typically passionate rather than rational: many observers are more concerned with "mounting emotionally laden attacks and defenses of the process than examining it dispassionately" (Ranis and Schive, 1985: 85). Secondly, there are so many qualitative as well as quantitative aspects that could be legitimately considered when one talks about FDI. For example, the impact of FDI in a country's economic development can be assessed by way of both qualitative and quantitative methods. Thirdly, it is conceptually, as well as empirically, extremely difficult to disentangle the contribution of FDI to a country's development from that of so many other factors, including political, historical, and legal factors, simultaneously at work within the development process. Because of its complicated nature, few scholars have engaged in interdisciplinary research on FDI. Especially, the relationship between FDI, economic development, and law has remained a research subject which still needs much attention.

1.1.2 Why is the Case of Taiwan Important?

This research seeks to examine the interaction between FDI, legal reform, and economic development in the context of Taiwan. There are a number of reasons for choosing Taiwan as a research subject.

(A) Insufficient and Incomplete Research on Taiwan

First, Taiwan has long been characterized as an ‘economic miracle’ that has produced an extremely rare combination of ‘growth with equity’ despite a constant military threat from the People’s Republic of China (PRC) since 1949. The role of FDI has been significant in the growth process in Taiwan as the economy changed from that of a pre-war colony to one of the contemporary world’s most successful cases of development. In spite of this, neither the interaction between Government economic policy and FDI nor the contribution of law to economic development in Taiwan has received the scholarly attention one might have expected. Furthermore, because of Taiwan’s difficult political status, lawyers in Taiwan tend only to study municipal FDI laws; many important international law norms regarding the treatment of FDI, whether deriving from customary international law or from bilateral investment treaties, are hardly mentioned.

Internationally, few non-Taiwanese scholars have studied Taiwan. Since social scientists in the West formerly regarded the history of Taiwan as Chinese local history, the study of Taiwan has long been an offshoot of Chinese studies. As Taiwan came to be recognised as one of the so-called ‘Four Little Dragons’, or ‘Newly Industrialising Countries’ (NICs), in the 1980s, scholars in the West have started to discuss the reasons for the success of post-war development in Taiwan from the point of view of economics, employing a great number of mathematical instruments and models. However, most of them start their research from the year 1945. Fix (1988: 58) has pointed out that if the history of the Japanese period is not also studied fully, the development of Taiwan in the twentieth century cannot be

understood; and if the unique historical process involved in this development is not borne in mind, it is impossible to analyse social and economical changes in post-war Taiwan. Economic development is a continuous process and ignoring the pre-war history of Taiwan means that one cannot fully understand the progression of Taiwan's development. In addition, although there has recently been a trend in the West to separate the study of the economic development of Taiwan from that of mainland China, the place of law in the development process in Taiwan has continued to be neglected as a specific topic. It is not surprising therefore that there is little literature about the role of law in Taiwan's economic development.

(B) The Success of Taiwan Challenges the Traditional Theory of Development

The second reason for studying the case of Taiwan is that, because of the combination of political repression and economic liberalisation, its success “poses a *challenge to development theory as a whole and to law and development in particular*” (Adelman and Paliwala, 1993: 14). Rather than development theory, I will suggest below that Taiwan's success is instead consistent with one of the modern economic theories concerning foreign direct investment. Why does the success of Taiwan challenge both the theory of development and the theory of law and development? Before these questions can be answered, one has to know development theory and the theory of law and development.

(i) The Theories of Development

Development is a term with no generally-accepted definition (Black, 1991: 1-15).¹ Most commonly, national development is cast in economic images (Richardson, 1978: 3). The concept of economic development, however, is not

¹ The UNDP (1990: 10) defined human development as “a process of enlarging people's choices” and the 1986 UN General Assembly Declaration on the Right to Development (Resolution 41/128) states “that development is a comprehensive economic, social, cultural and political process, which aims at the constant improvement of the well-being of the entire population and of all individuals on the basis of their active, free and meaningful participation in development and in the fair distribution benefits resulting therefrom”.

unproblematic because different advocates of development theory have different ideas about what development is and what it should be.

Explanations of development can generally be classified into five schools of thought: the neoclassical conservatives, the liberal internationalists, social democrats (vulgar *dependentistas*), radical dependency theorists (*dependentistas*), and classical Marxists.² In brief, the neoclassical conservatives, notably Posner (1986: 1-2), emphasise the beneficial role of the free market, open economies, and privatisation, and argue that development should be equated with industrialization and rapid economic growth. The liberal internationalists, such as Bergsten (1978: 373-379), argue that economic growth does not equal development and see development as “growth with distribution” (Biersteker, 1987: 19). The social democrats (vulgar *dependentistas*), such as Seers (1972: 123), emphasise external and internal institutional and political constraints on economic development and stress that development must accomplish the satisfaction of basic needs, “incorporating a reduction in absolute levels of poverty, unemployment, and inequality”.

At the other end of the spectrum, the radical *dependentistas*, such as Frank (1979: xi), Amin (1976: 38), Cardoso and Faletto (1978: 10), and Richardson (1978: 4-11), assert that development of “peripheral” countries is virtually impossible in a global political economy dominated by capitalist relations³ and that

² For extensive surveys of development theory and practice, see Brookfield (1975), Adelman and Paliwala (1993: 7-10), Hettne (1995: 12-14), Peet (1991: 43-51), Seidman (1994: 57-141), Biersteker (1987: 11-51), Todaro (1989: 363-398), Brewer (1990: 161-199), and Todaro (1997: Chapter 3).

³ The world system theory was based upon the works of radical dependency theories and formulated by American political economic scholar Immanuel Wallerstein. He distinguishes three main “zones” in the global stratification system: an advanced “core”, an exploited “periphery”, and an intermediate “semi-periphery”. Wallerstein’s global core contains a disproportionate share of high-productivity, well-paid economic activities. The strong economic base both supports and is supported by strong states that also promote national cultural integration and cultural modernisation. The periphery contains a disproportionate share of low-productivity, low-paid economic activities. Their weak economic base means that peripheral economies are unable to maintain national independence and national integration in the face of external penetration.

development is “a consequence of a people’s frontal attack on the oppression, exploitation, and poverty that they suffer at the hands of the dominant classes and their system” (Cockcroft, Frank and Johnson, 1972: xvi). Thus they suggest that development is the creation of socialism or autocentric self-reliance. At the same time, classical Marxists, such as Warren (1973: 3-35) and Brewer (1990: 291), view development as an “inevitable process consisting of successive stages arising from the dialectical resolution of class conflict” (Adelman and Paliwala, 1993: 5), and refer to the term ‘development’ as capitalist development, i.e. capitalism.

Although some may be more satisfactory than others, I have reservations about each of the above theories of development because most development theory is not truly global. However, this research will not try to determine which approach most closely approximates to the global ‘truth’ for a slightly different reason. This is that development has qualitative dimensions, such as human rights and cultural identity,⁴ which are difficult to assess. These dimensions are not only quantitatively difficult to assess, but also *impossible* to compare with other qualitative elements. How does one weigh a unit of industrialisation against a unit of liberty? It cannot be done. So it is not suprising to see Adelman and Paliwala (1993: 10) state: “After four decades of development theory and practice, ... contradictions are little changed.... The complexities and contradictions of development resist easy classification or incorporation under the rubric of a single theory”.

Nevertheless, one of the aims of this research is to demonstrate how the success of Taiwan challenges traditional views in development theory. Few

The semi-periphery contains a mix of high-productivity and low-productivity economic activities. Semi-peripheral states usually are either losing a past effectiveness or gaining a future effectiveness, often drawing on national cultural traditions to mobilise domestic support for economic modernisation. The middle zone acts partly as a buffer against direct political conflict between core and periphery, and partly as a bridge for upward and downward mobility between them (Wallerstein, 1974: 346-357; 1979: 95-118). Evan (1985: 192-226) identified the semi-peripheral states as “newly industrialising countries”.

⁴ Thus, Bondzi-Simpson (1988: 643-645) has argued that economic development cannot be pursued at the expense of human rights and cultural identity.

international entities have such an ambiguous diplomatic status, or such difficulty maintaining their external political autonomy as Taiwan. Yet, at the same time, few have achieved such rapid economic growth. Taiwan's formal external affiliations with international organisations remain fragile, but its economic (informal) ties to other societies remain robust. Furthermore, as will become obvious in the following Chapters, economic development in the case of Taiwan not only means economic growth but also *growth with equality*, something which does not completely fall into any of the above development theories. Taiwan does not have a *laissez-faire* economy, as described by neoconservatives, nor does it have class conflicts as asserted by the radical dependentistas or Marxists. Rather, the most important aim of economic development in Taiwan is a combined one: the accumulation of national wealth together with the improvement of its citizens' standard of living. It serves both 'state-centered' and 'people centered' definitions of development. The following economic and social indicators give some evidence of growth with equality in Taiwan:

- The per capita GNP rose from US\$ 196 in 1952 to US\$ 12,872 in 1996 (TSDB, 1997: 32).
- Foreign exchange settlements rose from minus US\$ 87.5 million in 1952 to plus US\$ 17.6 billion in 1996 (TSDB, 1997: 187).
- The unemployment rate fell from 4.4 % in 1952 to 2.6 % in 1996 (TSDB, 1997: 3).
- The enrolment rate of elementary school graduates into junior high school rose from 34.85% in 1952-53 to 98.89% in 1996-97 (TSDB, 1997: 266).
- The wealth difference ratio between the richest 20 % and the poorest 20 % in Taiwan rose by only 0.01 from 5.33 in 1964 to 5.34 in 1996 (CEPD, 1997: 6).

(ii) The Theories of Law and Development

A second aim of this thesis is to illustrate how the case of Taiwan challenges traditional theories of law and development.

The question of the role of law in the development process invokes disagreement amongst scholars. The instrumentalists, such as Seidman (1972: 686 and 1994: 125), argue that the utility of state-made rules (particular legislation) can foster development and the norms provided by law are a precondition for successful development. They have stressed that institutions play a central role in defining societies, their economies and their politics (March and Olsen, 1989: 2). The state and the legal order shape the institutions that allocate resources and empower oligarchies (Seidman, 1994: 31). Societies can purposefully change institutions only by altering the norms that define them: “rules are the midwives of organization” (Wunsch and Owolu, 1990: 10). From an instrumentalist perspective, the law can be moulded and manipulated by the developing states to influence, directly or indirectly, social behaviour in a non-contradictory fashion.

By contrast, others have suggested that in practice law does not have that capacity. Dhavan (1992: 10) argues that law tends to address national development rather than the development needs of individuals. Consequently, ruling interests have the opportunity to define national needs in terms that advance their self-interest. Tushnet (1985: 683) and Singer (1984: 1) caution that laws too often benefit only the rich and powerful. The term ‘economic development’ has frequently been used by autocratic leaders as a poor excuse for dictatorial regimes, colonialism and opportunism (Ghai, 1993: 51-75); where the rights and freedoms of people, and the proper use of natural resources and environmental protection have been regularly subordinated to the imperatives of industrialisation. These authors question whether the legal development is actually contributing to freedom, equality, participation, and shared rationality (Trubek and Galanter, 1974: 1063-

1064). They argue that the goals of legal instrumentalism are noble, but that the methods remain dubious, “especially when the lessons of dependency theory are borne in mind” (Adelman and Paliwala, 1993: 14). Adelman and Paliwala (1993: 13) claim that legal institutions are not panaceas for all development ills: class conflict or socio-cultural relations may affect the functionality of the law.

It is certainly true that political decisions and law-making form complementary parts of a single, complex, interrelated process (Lowi, 1987: 1070), and that this creates the possibility of abuse of the legislative process by vested interests capable of influencing government policy. Nor is law a panacea for all social evils. Nonetheless, in my view, law can foster development if the political purpose of the law is to serve the public interest. Its success in doing so depends upon (i) there being an appropriate political system, (ii) that the system adopts the right goals for achieving economic development, and (iii) that it frames laws capable of effectively achieving those goals. As to (i), the quest for social and national development must ensure that an appropriate political system is locally rooted, popularly accepted, and capable of responding to the public interest (Bondzi-Simpson, 1992: 4). Regarding (ii), any form of appropriate social and national development must also involve an economic environment that encourages efficient and skilful use of human and natural resources. In particular, the legal system of developing countries must devise appropriate commercial and labour relations regimes for both public and private transactions (Bondzi-Simpson, 1992: 5). In order to achieve those goals, the law is required both to encourage economic activity and at the same time to curb opportunistic behavior and to control or compensate for negative effects (iii). It must be practical, i.e. capable of implementation,⁵ and it has to be adjustable in accordance with national development needs.

⁵ Seidman (1994: 43) states that because “the devil is in the details”, the instrumental use of law requires careful formulation to ensure effective implementation.

It is a hard task but, in my view, not an impossible one. Taiwan, in particular, provides distinctive opportunities for re-examining the role of law in national development. The development process of Taiwan involves a high degree of control over the national (labour) market and extensive state intervention to take advantage of international political and economic conditions. Law is used in Taiwan as a instrument to facilitate the implementation and achievement of the Government's policies, and to serve the needs of national development and the needs of the public interest. The role of law in Taiwan's development challenges the liberal assertion that authoritarianism is incompatible with capital accumulation and challenges the necessity of imposing constitutionalism, the rule of law, freedom and human rights as preconditions to sustain market mechanisms. By looking in this thesis at each development phase in Taiwan, I will examine the role of law in Taiwan's development process and see how Government policy through law has shaped and reshaped Taiwan's economic development; and how the Government constantly utilises legal reforms to provide greater participation (e.g. through land reform), as well as to meet existing development needs, and to create a favourable environment to ensure future development.

(C) Taiwan's Experience Understood in Terms of Economic Theories Concerning Foreign Direct Investment

In terms of the relationship between FDI, law and economic development, the case of Taiwan appears to demonstrate the validity of one particular economic theory of FDI. This is the third reason to choose Taiwan as a case study.

Foreign investment is one form of economic transaction between countries (Richardson, 1978: 13).⁶ A combination of fear and welcome towards foreign investment can often be observed in developing countries. As Hirschman (1969: 3)

⁶ Richardson (1978: 13) suggests that economic transactions among countries take three principal forms - foreign trade, private investment, and foreign aid. For details, see also Katzenstein (1975: 1024-1034).

has noted, foreign investment “shares to a very high degree the ambiguity of most human inventions and institutions: it has considerable potential for both good and evil”. The conflicts between different economic theories have had an impact in shaping legal attitudes toward FDI.

The classical economic theory of FDI takes the view that FDI is wholly beneficial to the host country’s development. It believes that economic development can be facilitated by FDI transfers that add to the available stocks of capital, knowledge, and technology. This classical theory has a strong hold over the policies underlying the international law principles on FDI. The preambles of bilateral investment treaties all contain similar statements: “such investment will be conducive to stimulating business initiative and increasing prosperity”.⁷ In addition, the classical theory can be observed in diverse instruments, including the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention),⁸ the Convention establishing the Multilateral Investment Guarantee Agreement (MIGA)⁹ and the 1992 World Bank’s Guidelines

⁷ For instance, the Taipei-Thailand Investment Protection Agreement (1996) and the ROC-Paraguay Investment Guarantee Agreement (1992).

⁸ The preamble of the ICSID Convention states that the Contracting States believe that provision for the settlement of disputes arising from FDI will increase flows of foreign investment which are beneficial to the economic development of the developing countries. For the text, see 575 U.N.T.S. 159; 4 *I.L.M.* [1965] 532.

⁹ The preamble of the MIGA Convention states that to devise a scheme for the insurance of foreign investment is necessary because it will facilitate the flow of FDI into developing countries, especially when there is a decrease of such flow due to risk perceptions of FDI (Shihata, 1988: 356).

on the Treatment of Foreign Direct Investment.¹⁰ Furthermore, the classical theory has also affect the thinking of arbitral tribunals.¹¹

By contrast, the dependentistas assert that FDI cannot bring any meaningful economic development to the host country, and full economic development can never be achieved as long as developing countries are tied to the principal economies through foreign investment.¹² Their recommendation is to get rid of FDI rather than to attract it. This theory has been popular in the Latin American countries and forms a part of the political programmes of governments (Manley, 1991: 80-110). Nationalisations in Chile, Peru, and Jamaica were influenced and purportedly justified by these theories¹³

Other theorists adopt a middle path; they believe that FDI through MNEs could have harmful results in certain circumstances but assert that, properly harnessed, MNEs could be engines that fuel the growth of the developing world (Sornarajah, 1994: 46). This view has received support from many American and European scholars.¹⁴ The theory has affected the legislation governing FDI in many developing countries which have set up screening bodies that permit entry or give incentives to selectively approved investments. On the international plane, the

¹⁰ The 1992 World Bank's Guidelines states that it recognises "that a greater flow of foreign direct investment brings substantial benefits to bear on the world economy and on the economies of developing countries in particular, in terms of improving the long term efficiency of the host country through greater competition, transfer of capital, technology and managerial skills and enhancement of market access and interms of the expansion of internaitonal trade" (31 *I.L.M.* [1992] 1379).

¹¹ For example, after referring to the ICSID Convention's preamble, the tribunal in *Amco v. Indonesia* said that "... to protect investments is to protect the general interest of development and developing countries" 23 *I.L.M.* [1984] 351.

¹² For details of these theories, see Peet (1991); Hettne (1988: 12-14); Evans (1979); Biersteker (1987: 3-51).

¹³ For an assessment of the capacity of these justifications to influence the law, see Manley (1991: 100).

¹⁴ See, for example, Bergsten, Horst, and Moran (1978).

theory challenges many classical propositions relating to FDI in international law.

As Sornarajah (1994: 48-49) states:

“The effect of the acceptance of the new theory is that foreign investment is entitled to protection only on a selective basis, dependent on the extent of the benefit it brings the host state and the extent to which it had behaved as a good corporate citizen in promoting the economic objective of the host state.”

In terms of international law, the validity of national legislation governing FDI is based upon the principle of the sovereignty (including economic sovereignty) of states. However, the increasing levels of administrative control over FDI involved in such legislation creates greater potential for conflict between the goals of foreign investors and the host State (UNCTC, 1992: 6-7). Traditional international law, in accordance with classical principles, sought to protect FDI through imposing minimum standards of treatment and insulating FDI from treatment in accordance with some or all of the host's municipal laws. Host States, by contrast, have sought to increase municipal control over foreign investments on the basis of international economic sovereignty (These issues are discussed in detail in Chapter 11).

According to the third, or moderate, theory of FDI, outlined above, law is an instrument through which development in all its dimensions may be pursued. While it is certainly true that nearly every economy in the world has imposed restrictions on the operation of foreign investment, the multinational enterprise “is not an unprotected, misused pawn of omnipotent nations; it is a powerful player in the international business game” (Robock, Simmond, and Zwick, 1977: 277). The laws relating to foreign investment should be regarded as a device for developing countries to balance the trade-off between costs and benefits. They should also be regarded as a ‘doorkeeper’, employed to attract more foreign investment without risking sovereignty.

Taiwan's success is evidence in favour of this balanced approach. There has been considerable State regulation and intervention accompanying the process of industrialisation in Taiwan (Chu, 1989: 647; Naya and Ramsteeter, 1988: 57). An

approach which mixes regulation of and receptiveness to FDI in Taiwan reflects the moderate theory of foreign investment. In this thesis, I will explain how the ROC government has changed its attitude towards FDI in accordance with Taiwan's economic situation; and how the Government uses state regulation to both control and attract FDI, in order to help Taiwan's economic development. Reference will also be made to international law principles when examining the ROC's treatment of foreign investment in Taiwan.

1.1.3 Is Taiwan A Developing Country?

In the context of the theories discussed above, one comment that may be made is that the conflicts between the various development theories, as between the economic theories concerning FDI, often reflect differences of value and interest amongst the developing and developed world. Because this research focuses on Taiwan, it is important to know where Taiwan stands: is Taiwan a developing country? Relatedly, another important question is - what is a developing country? There is no single standard or criterion defining a developing country for the purposes of international economic law. One has to look at this question in the context of individual international organizations and also, of course, in the specific context of the domestic law of particular states.

Economic indicators, such as per capita gross national product (GNP), the percentage average annual growth rate of GNP, the percentage average annual rate of inflation and life expectancy at birth are often used to evaluate the performance of countries (IBRD, 1989: 164). The Organization for Economic Cooperation and Development (OECD) distinguishes between the following types of developing country by reference to the GNP criterion: low-income countries and territories (LICs) whose per capita GNP is under US\$ 675; low middle-income countries and territories (LMICs) whose per capita GNP is between US\$ 676 and US\$ 2,695; upper middle-income countries and territories (UMICs) whose per capita GNP is

between US\$ 2,696 and US\$ 8,355, and high-income countries (HICs), whose per capita GNP is over US\$ 8,355 (OECD, 1996a: 5). The range provided by the World Bank is slightly different and is as follows: LICs, under US\$ 725; MICs, US\$ 725 to under US\$ 8,956; and high-income economies (HIEs), over US\$ 8,956 (IBRD, 1996, vol. 1: 188).¹⁵ Of course, classification by income does not necessarily reflect development status. Other economic indicators used by international agencies to compare and categorise countries include the degree of industrialisation of a nation and the availability and affordability of social services such as education and health (Bondzi-Simpson, 1992: 2). The per capita GNP in Taiwan in 1996 was US\$ 12,872, ranked 25th highest among countries with a population of over 1 million in the world (CEPD, 1997: 4). It thus belongs to the HIC/HIE category according to the OECD and the World Bank criteria.

For the purposes of the GATT and now its successor organization, the World Trade Organisation (WTO), there has been no clearly-accepted definition of a developing country (McGovern, 1995: 9.21-1).¹⁶ States have been allowed to claim that status themselves, in a process of self-selection. On this basis, countries which are similar to Taiwan in terms of economic development, including Korea and Singapore, have been accepted as developing States. Therefore although Taiwan for political reasons has not yet gained admittance to either the GATT or the WTO, nevertheless it is apparent by analogy that it would probably be considered a developing country in terms of international practice in the area of trade.

¹⁵ In the World Bank's classification, low and middle-income economies are referred to as 'developing economies' (World Bank, 1995: viii).

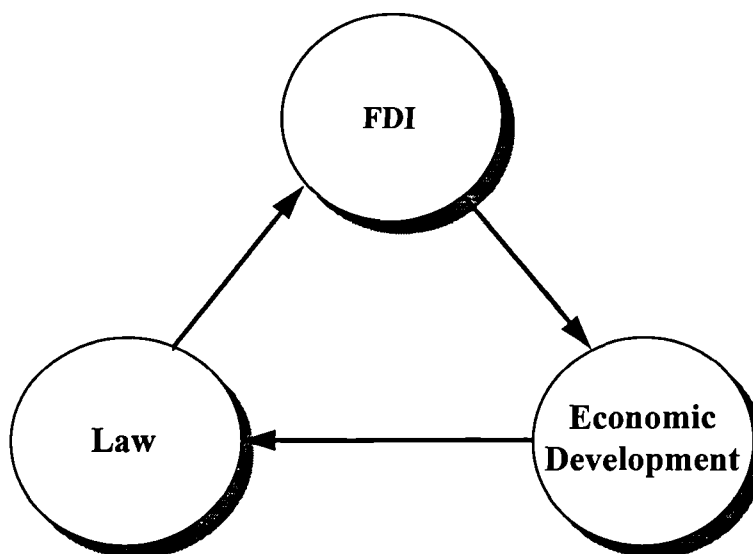
¹⁶ "There is no formal definition of a developing country. There is an informal group of such countries, the chairman of which invites new Members to join if they claim that status. The system worked satisfactorily under GATT. ... developing countries ... include(d) countries such as Korea and Singapore. The same approach will be adopted under the WTO and is proving controversial only in the case of China, for which the issue is likely to be made explicit in the instrument by which it joins the WTO." (McGovern, 1995: 9.21-1)

Taiwan is one of a group of developing countries which has sought to use FDI as part of its general development strategy. But is it really any longer a developing country? Clearly, the economy of Taiwan has undergone a major change since 1945, but certainly at the beginning of the period of this study, Taiwan was a developing country. Even now, in terms of the practice of GATT, the WTO, the OECD and the World Bank, Taiwan would be entitled to treatment as a developing country, albeit a high-income one which is characterised by a high level of exports of manufactures. However, if it continues to maintain the rapid economic growth it has experienced in recent years, Taiwan at some point will graduate from this category altogether.

1.2. Theoretical Assumptions Concerning the Relationship between FDI, Economic Development and Law

Law is a driving force behind the economy and the economy is a driving force behind law. In the previous section, I suggest that traditional development theory is inadequate when applied to Taiwan. As an alternative, therefore, the following triangular model is proposed for explaining the relationship between FDI, economic development, and law.

Figure 1.1 Foreign Direct Investment: Legal and Economic Interaction Model



In this diagram, “Law” refers to the laws, regulations etc. governing FDI. The arrows are indicators of influence. The model is intended to express the four following propositions:

1. FDI can facilitate economic development only if the appropriate laws are adopted.
2. As FDI facilitates economic development, and the level of economic development changes, the Government responds with new laws or legal reforms in order to encourage further economic development. The content of these laws is shaped by the levels of economic development.
3. The restrictions and incentives provided for by law (and by legal reforms) affect the performance of FDI. Consequently, the performance of FDI affects the performance of a country’s economic development.

4. In the case of Taiwan, appropriate liberalisation of the law leads to more inflows of FDI, which leads to further successful economic development.

The model formulated above is, it is hoped, substantiated by the practice of Taiwan as examined in this thesis.

1.3 Objectives of this Research

Virtually every economy in the world has imposed restrictions on the operation of foreign investment. However, one might expect that a country seeking to encourage large-scale foreign investment would choose to adopt an investment regime which is very open towards foreign investment. Conversely, one might expect that a country pursuing a process of economic development which largely ignores foreign investment would not develop its foreign investment regime in such a way as to be particularly attractive to foreign investors.

Apart from considering Taiwan's development in light of the model described in the previous section, this research is also concerned, in particular, with the contribution of the legal regime governing FDI to economic development in Taiwan. A primary objective of the research is to ask to what extent does the character of Taiwan's foreign investment regime contribute to Taiwan's economic development? In addressing this question, I will first survey Taiwan's economic development up to 1945, in order to provide the contextual background for analysis of Taiwan's development after 1945, and to illustrate how Taiwan's early economic regulation and policy was dependent particularly upon its political and constitutional status. Secondly, I will look at the role of FDI in the economic development strategy of Taiwan from 1945 to the present. The operation of the legal regime will be examined in its appropriate economic, social, political and historical context. Finally, I will analyse in some detail the current legal regime

governing FDI in Taiwan, with appropriate references to international legal norms governing FDI.

However, it is important to emphasise that this research, which is focused on Taiwan, may not disclose a successful development model for other developing countries. As one of the newly industrialised economies (NIEs), Taiwan's success is the outcome of its historically-shaped institutional, economic and political circumstances. These conditions are almost impossible to reproduce. Because of Taiwan's desperate political situation in the 1950s, US aid financed 25 to 30 per cent of the Government's consolidated budget expenditure, including the defence budget, for nearly two decades.¹⁷ US aid totalled roughly 7 per cent of Taiwan's GNP, at times reaching almost two thirds of Taiwan's total investment (see Chapter 4). Simultaneously, Taiwan benefited from relatively large-scale foreign investment, mainly in labour-intensive manufacturing industries (see Chapter 5). The Korean War in the 1950s provided a major market for Taiwanese products required for the United States' offshore procurement programme (see Chapter 4). Stimulated by the success of land reform in the 1950s (see Chapter 4), Taiwan had built the necessary economic foundations to benefit from the rapid market growth generated by the Vietnam War in the 1960s (see Chapter 6). In the view of some, Taiwan at the same time "wisely refrained" from pursuing democratisation at the same time as economic development (Jacoby, 1966: 125-126); instead it provided a stable political framework for economic development, and let political reforms come later (see Chapter 8).

Although the development model for Taiwan is unlikely to be copied by other developing countries, policy-makers can still learn from Taiwan's experience, especially its experience in dealing with FDI. By using the problem-solving

¹⁷ Taiwan's armed forces, about 600,000 strong, incorporated the largest percentage of the adult population of any country in the world (equivalent to a US military force of some 10-11 million men). Its military expenditures constituted 9-11 per cent of the GNP, also the highest percentage in the world (Jacoby, 1966: 119-125).

strategies regarding economic development which were implemented by Taiwan, an invaluable source of information can be provided for other developing countries. Information about the strategies that Taiwan tried, and how well they worked, can provide indications regarding possible strategies that may be pursued in other developing countries. Taiwan's experience can also shed light on the potential social costs and benefits of these various strategies.

1.4 Organisation of Study

Apart from the introduction (Chapter 1), and the conclusion (Chapter 12), this research is divided into three main Parts. Overall, this research is organised chronologically because the economic and legal development of Taiwan, in the context of FDI, involves social change and the interaction of various factors which cannot be fully understood unless a historical context is provided.

Part One examines the economic development of Taiwan before 1945. It is clear that FDI in Taiwan in any meaningful sense did not begin before that date. However, this research seeks to integrate economic policy, law and economic development. The thesis is not concerned solely with the laws governing foreign investment in Taiwan, but also addresses the issue of foreign investment in the broader development of Taiwan. Therefore, Part One will provide the background to Taiwan's development since 1945. The Chapters in Part I set out the principal geographical features of Taiwan, its early development and the period of colonisation by Japan (Chapters 2 to 3).

Chapter 2 examines the historical and economic background of Taiwan under successive political regimes before 1895. It also evaluates the geographical setting and many of the policies adopted by different political regimes that have contributed to its economic and political evolution.

Chapter 3 surveys the economic development of Taiwan as a Japanese colony from 1895 to 1945, and the capital inflows during this colonial period. The Chapter concentrates on the system of economic control exercised by the Japanese, and is especially concerned with the economic measures adopted by the Japanese which laid the foundations for Taiwan's post-war development.

Part Two of the thesis examines the interaction between law, policy and economic development in the context of FDI from 1945 to 1983. This Part places heavy emphasis on the Government's economic policies, and on its policies regarding FDI in particular. This emphasis is necessary, of course, because economic policy determines in principle the forms of FDI which a State wishes to attract. In addition, economic policy may affect the results of legal reform and may affect the likelihood of successfully attracting substantial inflows of FDI. Part Two is divided into four chapters in accordance with Taiwan's four major economic development phases.

Chapter 4 looks at Taiwan's post-war political and economic situation from 1945 to 1952. This Chapter focuses on how the Government adopted economic policies to stabilise its economy after it lost the civil war, and on the implementation of the land reforms which were to have a significant influence on Taiwan's later success. The Government's economic doctrine - *Sun Min Chu I* - is also introduced in this Chapter, with a discussion of how it affected the Government's policy as a whole and its policies on FDI in particular.

Chapters 5 through Chapter 7 examine law, policy, and FDI during the primary import-substitution phase, primary export-substitution phase, and secondary import and export substitution phase, respectively. Each Chapter contains a brief analysis of the then current legal regime governing FDI in Taiwan. The legal analysis is presented in the context of a broader analysis of social, political and economic development of Taiwan. The chief purpose of these

Chapters is to explore how the Government used law to facilitate its economic policies, how actual FDI responded to the Government's various policy and legal reforms, and how FDI assisted Taiwan's economic development.

After looking at the historical foundations of the present system and at the policies that have contributed to its evolution, a detailed analysis of the current legal regime governing FDI in Taiwan is presented in Part Three. This Part also contains critical comments on current FDI laws as well as suggestions for further legal reform. Part Three comprises Chapters 8 to 11.

Chapter 8 discusses the interaction of law, policy, and FDI from 1984 to the present. The purpose of this Chapter is to shed light on Taiwan's current economic policies and to show their impact on legal reform and on FDI performance in Taiwan. 1984 is chosen as the cut-off point between Part Two and Three because the Government first employed a version of its modern economic policies following the 1970s oil crises. The essential nature of these policies have remained unchanged from then until the present day.

Chapter 9 discusses two different types of FDI in Taiwan, known as FIA and non-FIA investment, and examines various forms of business activity involving FDI in Taiwan and the legal constraints affecting those forms. The differences between FIA and Non-FIA investment usefully illustrate the Government's qualified welcome of FDI; in addition, discussion of regulatory control of FDI and the survey of forms of business activity is used as an introduction for further analysis of Taiwan's legal framework in Chapters 10 and 11.

Chapter 10 deals with the concept of FDI, under both domestic investment laws and under bilateral investment treaties concluded by Taiwan, and also with residence aspects related to FDI. The purpose of this Chapter is to investigate the eligibility of FDI in Taiwan and the legal requirements for admission and to set out

the formal and substantive rules governing the admission of FDI and the formation of business organisations which carry out investment activities.

Chapter 11 focuses on the form and content of the legal treatment of FDI, especially regarding incentives and protection for investors. The analysis of the municipal laws is integrated with a discussion of relevant rules of international law. The question of the protection of foreign nationals, including the standard of treatment for foreign investment and the possibility of expropriation of foreign property, is examined. Other specific legal measures, such as repatriation privileges and the waiver of securities and Company Law requirements, are considered. Finally, when disputes arise regarding an investment, the question of what kinds of mechanisms are available to foreign investors in Taiwan is reviewed.

1.5 Methodology

The research for this thesis was carried out from 1993 up to the date of submission. Except for some information gathered from the 1997 Government economic records and from newspapers, books and articles, available data is as at the end of 1996. The law is also stated as it stood in 1996, although any very recent legal developments known to the author are included. The selection of data for inclusion in the thesis was based on its representative character for the subject area or areas it covers.

A few informal interviews were conducted by the author during the course of this research. The interviewees included academic experts, lawyers, and government officers in Taiwan. Although the texts of the interviews are not cited directly in this work, the thesis would not have been completed without the stimulation and inspiration provided by the interviewees.

For this study, I have referred to both primary and secondary sources which related to the topic. They were collected in Taiwan and Britain from the following:

- Board of Foreign Trade, Ministry of Economic Affairs: Taipei, Taiwan.
- Industrial Development & Investment Centre, Ministry of Economic Affairs: Taipei, Taiwan.
- Investment Commission, Ministry of Economics Affairs: Taipei, Taiwan.
- Ministry of Foreign Affairs: Taipei, Taiwan
- Council for Economic Planning and Development, Executive Yüan: Taipei, Taiwan.
- Overseas Chinese Affairs Commission: Taipei, Taiwan.
- Science-based Industrial Park Administration: Hsinchu, Taiwan.
- Institute of European and American Studies, Academic Sinica: Taipei, Taiwan.
- Institute of Economics, Academic Sinica: Taipei, Taiwan.
- Chung-hua Institute of Economics: Taipei, Taiwan.
- National Central Library: Taipei, Taiwan.
- Taipei City Library, Central Library: Taipei, Taiwan.
- Legislative Yüan Library: Taipei, Taiwan.
- Taipei Representative Office in the U.K.: London.
- Majestic Trading Co., Ltd. (Taiwan Trade & Investment Service): London.
- Main Library and Harding Law Library, University of Birmingham: Birmingham.
- Central Campus Library, University of Warwick: Coventry.
- Cambridge University Library and Squire Law Library: Cambridge.
- Bodleian library, Oxford University: Oxford.

- Library of LSE, University of London: London.
- Library of SOAS, University of London: London.
- Library of Institute of Advanced Legal Studies: London.

There has been no use of questionnaires in the research conducted for this thesis.

Finally, this work represents a scheme of analysis that involves reference to historical, political, social and, of course, economic factors in all the important areas of this study namely, foreign investment, economic development and their legal regulation. It uses a multi-disciplinary methodology encompassing various socio-scientific disciplines in addition to law.

1.6 Limitations of the Research

It is important to state that this research is not directed at attempting to find out precisely, based on mathematical methods or quantitative findings, how much of the developmental success of Taiwan can be attributed to FDI. Instead, it is assumed that FDI, when under the control of the host state's laws, can help that country's economic development, at least to a certain degree. The thesis is concerned with an assessment of *how* FDI has responded to the Government's policies as implemented through legal reforms, in association with many other internal and international factors determining Taiwan's economic performance. While it seems clear that the role of FDI in any particular economy cannot be assessed independently of the overall working of the economic system, this thesis will concern itself with the general development process in Taiwan only to the extent necessary.

1.6.1 International Law Regarding Foreign Direct Investment in Taiwan

A host state's treatment of foreign investment can involve a consideration of issues of international law. However, there is no extensive analysis of international questions in this thesis. Normally, even though the municipal law maybe the primary concern of scholars researching FDI in a particular country, one would also expect to find many relevant multilateral and bilateral treaties. However, due to political and legal reasons, this is not the case with Taiwan. Because the 'ROC' is not recognised as a sovereign state by most countries, Taiwan is excluded from virtually all multilateral investment treaties and from relevant international organisations. This is true even for bilateral investment treaties. Other States have been reluctant to enter into bilateral investment treaties with Taiwan because of the implications this may have for their non-recognition of Taiwan and because of the potentially harmful effects on their relationship with the People's Republic of China. Taiwan has concluded only 10 bilateral investment agreements as at August 1997. Therefore, many of the usual international law references are missing from this thesis. However, rules of customary or general international law remain relevant to the treatment of FDI in Taiwan.

This complex situation also affects the mechanisms for dispute settlement in Taiwan (see Chapter 11). Normally, the internationalisation of dispute settlement involving foreign investment is a prominent feature. Again, Taiwan is in an unusual position: legally speaking, it has been excluded from the World Bank, ICSID, and MIGA. Therefore, the techniques and methods of dispute settlement available under the auspices of these institutions, can not be applied in the case of foreign investment in Taiwan.

However, although Taiwan is excluded from all relevant international organisations and is not a party to relevant international treaties, the general rules of customary international law regarding the treatment of foreign investments, as

stated above, remain applicable to foreign investments in Taiwan. I will thus refer to the relevant rules of customary international law as appropriate.

The reason this thesis does not deal with issues arising from the Agreement on Trade Related Investment Measures (TRIMs), which is part of the WTO Code,¹⁸ is because, under the informal consensus between WTO Members, Taiwan may get admission to the WTO only after the PRC has joined the organisation (*FCJ*, August 1, 1997). Although joining international organisations remains the Government's target (see Chapter 8), unfortunately it is unlikely that Taiwan will be granted Membership in the WTO in the foreseeable future. Therefore, there is no practical reason in this thesis for discuss TRIMs.

1.7 Terminology and Languages

1.7.1 Terminology

The use of certain terms employed in this thesis requires explanation.

(A) Foreign Direct Investment:

In a broad sense, foreign investment includes governmental and non-governmental, and short- and long-term movement of assets (Schive, 1994: 413-414).¹⁹ In other words, foreign investment comprises both portfolio and direct investment. Foreign direct investment in this thesis means the phenomenon of non-governmental long-term assets movement. In addition, the word 'direct' not only means the foreigner invests in a business in the host country but also that he controls that business. In contrast, portfolio investment is a "movement of money

¹⁸ See, generally, Trebilcock and Howse (1995).

¹⁹ Oman (1995: 73) has stated that FDI "comprises short- and long-term debt as well as equity and reinvested earnings".

for the purpose of buying shares in a company formed or functioning in another country” (Sonarajah, 1994: 4).²⁰ The distinguishing element between portfolio and direct investment is that direct investment “connotes a certain degree of control over management decisions”, whereas portfolio investment does not (Billet, 1993: 12). Portfolio investment includes ownership of government bonds and foreign securities, for example, and will not be of further concern here. Further discussion of the definition of FDI with reference to academic writers, international instruments, and the laws of the ROC can be found in Chapter 10.

(B) Taiwan:

The Republic of China (ROC; also known as Taiwan) government currently controls the Taiwan, Penghu (Pescadores), Kinmen (Quemoy) and Matsu areas and the South Sea Islands. Officially, the ROC also comprises the Chinese Mainland, and Taiwan is its smallest province (GIO, 1993a: 3), comprising the main island of Taiwan (Formosa) and the surrounding eighty-five islands, primarily the Penghu Archipelago. Kinmen and Matsu are part of Fukien Province. The South Sea Islands are uninhabited and form part of no province: they consist mainly of coral reefs, sandbars and islets (DGBAS, 1989: 1).

For political reasons, since 1949 when the Nationalists were defeated by the Communists and moved the ROC government to Taiwan, the name ‘Taiwan’ has gradually displaced the official name ‘Republic of China’ among international organisations and in other contexts. Nowadays, when people mention ‘Taiwan’ as a country's name, they frequently do not mean ‘Taiwan island’ but the ‘Republic of China on Taiwan’ or the ‘present governmental home of the ROC’. Therefore, in

²⁰ Shihata (1993: 2) gives portfolio investments a more elaborate description. He asserts that portfolio investments are those investments “made through debt and equity instruments. The debt instruments include bonds, commercial paper and certificates of deposits, while the equity instruments are composed of country funds (both closed and opened ended), external stock offerings (through US and global depository receipts) and direct purchases of shares in emerging capital markets by external residents”.

order to avoid misunderstanding, and to resolve the conflicting truths of geography, history and politics, it is necessary to define the term 'Taiwan' as used in this thesis. In this study, 'Taiwan', before 1949, refers to geographical Taiwan (i.e. Taiwan island), while 'Taiwan' after 1949 refers to the political entity known as Taiwan (i.e. the Taiwan, Penghu, Kinmen and Matsu areas).

(C) Taiwanese:

Like the English in New Zealand, the Han Chinese formed a settler's culture on the island of Taiwan. For the purposes of this thesis, the 21.3 million people who live on Taiwan today²¹ are all considered to be Taiwanese no matter when they arrived. They comprise: (1) 'aboriginal Taiwanese' (*Yuan-chu-min*), i.e. descendents of the aborigines who inhabited the island before Han Chinese arrived (see Chapter 2), and who still maintain their indigenous culture; (2) 'original Taiwanese' (*Pen-shen-jen*), i.e. the southern Fukienese and Hakka people (*K'o jen*, 'guest people') who migrated to Taiwan before 1949, and their descendants, and (3) 'continental Taiwanese' (*Wai-shen-jen*) i.e., immigrants from continental China after 1945 and their descendants.

In order to remain consistent with the definition of 'Taiwan' employed in this research, before 1949 the term 'Taiwanese' includes the Han Chinese and aborigines who lived on geographic Taiwan. However, the term 'Taiwanese' after 1949 comprises all people who live in political Taiwan.

(C) Japanese:

The term 'Japanese' refers to '*naichijin*' (mainlanders) including those who initially lived in Japan but then came to reside in Taiwan for short-term or long-term purposes, as well as their descendants.

²¹ At end of 1996, Taiwan's population stood at 21.4 million (CEPD, 1997: 2; TSDB, 1997: 8).

1.7.2 Languages

The use of languages in this thesis also needs to be mentioned. Language may be seen as an indication of historical heritage (Gallin, 1966: 18). Because Taiwan has been ruled by different regimes at different times, with different languages and legal systems, it has been decided in this thesis to use terms in the official language employed in Taiwan during the given period.

The terms for the institutions and agencies of the Ch'ing period will be translated according to Mandarin Chinese; those of the Japanese period according to Japanese. For example, the *Pao-chia* system in Ch'ing Taiwan was called *hoko* in Taiwan when it was a colony of Japan, although the characters are the same.

Due to the fact that the official language in Taiwan is Mandarin Chinese, all Chinese words used in the post-war period are in Mandarin rather than in the local Taiwanese (*Min-nan-hua*) or Hakka languages.²² Mandarin Chinese is romanised according to the Wade-Giles system rather than the Pinyin system which is used extensively in the People's Republic of China, with the exception of certain well-established place names, i.e., Peking for Pei-ching.

Most Chinese and all Japanese terms used in this thesis can be found in the glossary. Where a Chinese word appears only once in the text and is immediately explained there, it does not appear in the glossary of Chinese words.

²² Like Mandarin, Taiwanese and Hakka are usually referred to as dialects of Chinese. Taiwanese, also called *Min-nan-hua*, is a Fukienese language like Amoy. Hakka is spoken by the Hakka people (*k'o jen*, 'guest people') who originated in Kwangtung province on Mainland China.

PART ONE

ECONOMIC DEVELOPMENT OF TAIWAN PRIOR 1945

Foreign investment is closely linked with a country's economic development. At the same time a country's economic development is affected by various geographical and historical factors including natural resources and political development. Thus, one should not neglect the importance of discussing a country's early development, because it forms the basis for its modern development. During its early history Taiwan was, for a long time, neglected by the Chinese Empire because of its geographical setting. Before Taiwan was returned to the ROC in accordance with the Cairo Declaration of 1945, Taiwan had been ruled by Dutch, Cheng, Ch'ing and Japanese rulers. It would not be too exaggerated to say that the history of Taiwan was a record of subjection to aggression, dismemberment and humiliation by foreign powers. Different rulers in Taiwan have adopted different economic policies which were determined solely by their own interests.

The main purpose of Part I is to outline these different economic policies under the various rulers and to analyse how they affected Taiwan's economic development. In doing this, it is first necessary to mention the geographical features of Taiwan and to outline its early political and economic development before Taiwan became one of Japan's colonies in 1895. We will then look at the social conditions and economic policy that the Japanese adopted during the colonial period and which significantly affected Taiwan's later economic development. Thus, this Part falls into two Chapters. Chapter 2 provides background information about Taiwan and deals with its economic and political situation before 1895. Chapter 3 examines the Japanese colonial economic strategy and how that strategy

shaped Taiwan's infrastructure in a way which was later to help Taiwan's post-war recovery and transformation which will be illustrated in Part II.

Chapter 2

Economic Development of Taiwan: Early History

Taiwan in 1996 was the third largest holder of foreign reserves and the fourteenth greatest trading nation in the world (Chien, 1996). To appreciate fully how Taiwan has developed since the 1890s, it is essential first to take a long look backward. The purpose of this chapter is briefly to describe the economic conditions existing at the end of the nineteenth century and to review the economic and early political forces that helped to create these conditions. Geographical features, such as location and natural resources, will first be introduced to provide a general idea of Taiwan's natural condition. These factors have played a significant part in its history: for example, Taiwan's unique geographic location has caused it to change hands many times. In the second part of this chapter, political and economic development during Taiwan's early history will be considered.

2.1 Geographical Features

2.1.1 Location and Size

It is useful to begin with some background information. Taiwan, a 'tobacco-leaf-shaped' island, lies between 119°18'03" and 124°34'09" East Longitude, and 21°45'25" and 25°56'21" North Latitude (DGBAS, 1989: 1). It is almost exactly bisected by the Tropic of Cancer, about 100 miles (160 kilometres) off the Southeast coast of the Chinese mainland, some 665 miles (1070 kilometres) south of Japan, and 217 miles (350 kilometres) north of the Philippine Archipelago (GIO, 1993b: 5). With a land area of approximately 14,000 square miles (36,000 square

kilometres), Taiwan is closest in size to the Netherlands among European countries (Wan, 1981: 131; TBMOC, 1991: 7).

The total area of the Penghu Archipelago, formerly known as the Pescadores, is only about 50 square miles, consisting of sixty-four islets (Hsieh, 1964:6; TVA, 1994: 34). Scattered slightly east-of-centre in the Taiwan Strait, the Penghu Archipelago occupies an important strategic position, separating Taiwan from the Chinese mainland (U.S. Department of Navy, 1944b: 1,4).

Kinmen and Mastu are two island groups just off the south-eastern coast of the Chinese mainland (DGBAS, 1994). Kinmen consists of 12 islets covering an area of 150.45 square kilometres. Mastu is situated outside the mouth of the Min river, with an area of about 28.8 square kilometres (11.12 square miles) (GIO, 1993a: 6-7; GIO, 1993b: 6).

2.1.2 Natural Resources and Climate

Taiwan has limited natural resources. The most important mineral resource of the island is coal¹. Because most coal seams are extremely thin and slope steeply, only one-third of the reserve is economically recoverable (Hsieh, 1964: 106-111; Rhynsbarger, 1956: 152-53). The primary natural resource of Taiwan island is therefore agricultural rather than mineral. Agricultural production depends on soil fertility and climate conditions. Unfortunately, because only one-fourth of Taiwan's total area is arable,² and because the soil has been cultivated continuously and intensively for centuries, the available land is limited in both quantity and quality (Ho, 1978: 1).

¹ Taiwan lies in the same geological belt as the other important oil-producing areas in the Far East. In recent years small amounts of oil and nature gas reserves have been discovered in surrounding waters and islands (KPMG, 1995: 7), and many geologists believe that the prospect of finding additional oil and gas reserves in Taiwan or off its coast is quite good (Ho, 1978: 1).

² Approximately three-fifths of Taiwan island is covered with lush-forested mountains (KPMG, 1995: 7).

The sub-tropical (in the north) and tropical (in the south) climate extends Taiwan's growing season, and allows the cultivation of several harvests a year (KPMG, 1995: 7). The island enjoys a mean annual rainfall of more than 100 inches (2,500 millimetres) (TBMOC, 1991: 7; DGBS, 1994). However, as Taiwan lies in the path of the east Asia monsoon system, rainfall varies both geographically and seasonally; southern Taiwan suffers from frequent droughts, and northern Taiwan suffers from occasional floods (Ho, 1978: 1-2; GIO, 1993b: 6). Typhoons frequently hit Taiwan between July and September, and between 80 and 85 per cent of the annual rainfall comes during the late spring and summer months (Chen, 1950: 5).

2.2 Early Political and Economic Development in Taiwan (Pre-1895)

Taiwan's geographic location has caused it to change hands many times. Taiwanese history is generally divided into four periods before Taiwan was handed over to the Japanese in 1895. The divisions reflect changes in political control: prehistorical, Dutch colonisation, conquest by Koxinga, and rule by Ch'ing empire.

Historically, as we will see in this section, Taiwan had a traditional peasant economy. Toward the end of the seventeenth century, mainland Chinese peasants began to migrate to Taiwan in large numbers, providing the manpower to settle the island (1993b, GIO: 7). Over the following two centuries, population, cultivated land, and output increased slowly but steadily (Ho, 1978: 22). The economy was traditional in the sense that it was based on traditional agricultural methods, was fragmented, and was not highly commercialised. During the nineteenth century, Taiwan was partially opened to foreign traders. However, contacts with the outside world were limited to the treaty ports. For all practical purposes, at the end of the nineteenth century Taiwan remained a closed, self-sufficient economy.

2.2.1 Early Settlements

Before the commencement of migration by mainland Han Chinese in the seventeenth century, Taiwan was home to indigenous tribes.³ Unfortunately, there is no record of the origins of Taiwan's indigenous peoples (Hsieh, 1964: 125; Lumley, 1976: 41; Ts'ao, 1980: 40). There are two major theories about the origins of the indigenous tribes. Some scholars, including Alvarez (1927: 248), Lin (1930), Liao (1951: 151) and Shih (1980: 14-16), have claimed that the indigenous people came from Malaya, Indonesia and the Philippines, a claim based upon their language structure and cultural characteristics. Others, such as Ling (1958), Kano (1948) and Chen (1972), have used archaeological research to suggest that the first migration very likely came from the southern Chinese mainland. Whatever their beginnings, the productive activities of all the indigenous tribes were connected closely with the land; subsistence was provided by hunting, fishing, or farming (Tuan, 1992: 30).

Historically Taiwan was first mentioned in the Han Dynasty (206 B.C. - A.D. 221) chronicles, Hang-shu (the 'Book of History') and Tang-shih. The inhabitants of Taiwan were described as Tao-i (island savages) in the two books (Lumley, 1976: 41). There were no Han Chinese (Han-ren) settlers on this island at that time (Ibid). In 1430, Taiwan⁴ was claimed by Cheng Ho, the seafaring eunuch and magistrate, in the name of the Emperor of China (TBMOC, 1991: 7). Although precisely when the Han Chinese immigrated to Taiwan remains unknown,⁵

³ Taiwan's nine indigenous tribes, which immigrated at different times from differing places, and the later-arriving Han Chinese have made the island 'an anthropologist's laboratory' (Cheng, 1994: 3). The nine major aboriginal tribes in Taiwan are the Atayal, Saisiyat, Bunun, Tsou, Paiwan, Rukai, Puyuma, Ami, and Yami (GIO, 1993a: 8). Only the Yami tribe live outside Taiwan, on Orchid Island (GIO, 1993b: 10).

⁴ Pescadores had been made a part of Chinese territory earlier than was Taiwan, in 1171 during the Sung dynasty (1127-1279) (TVA, 1994: 34).

⁵ At least some Han Chinese from the southern Fukien Province of China (Ch'üan-chou) migrated to the Pescadores in the twelfth century (McAleavy, 1968: 333-334). The Mongol empire in

presumably the earliest Han Chinese to reach Taiwan were fishermen and traders, mostly from the southern Chinese mainland (Shih, 1980: 27-28; Ts'ao, 1980: 41-44; Kuo, 1973: 21-22; Tuan, 1992: 30; Wang, 1992: 27-28). Japanese pirates also visited the island occasionally. Primarily, however, the early economic history of Taiwan is a story of migration and land settlement.⁶

During the Ming dynasty (1386-1644), a 'maritime prohibition policy' (*hai-chin jen-t'sa*) prohibited trade outside China by sea. Consequently, Taiwan became an ideal shelter for Chinese and Japanese pirate-traders⁷ (Tuan, 1992: 30; Hung, 1981: 25-34). The only significant flow of immigration in the Ming dynasty was from the southern Fukien province of China during the famine of 1620, when the famous pirate-trader Cheng Chi-lung⁸ led over ten thousand starving victims to the southern coast of Taiwan. Some of these refugees later returned to Fukien coast, while others decided remain (Huang, 1969; Lien, 1918). With the backing of the settlers, Cheng Ch'eng-kung, the son of Cheng Chi-lung, would go on to establish the Cheng regime on Taiwan in 1662 (see Chapter 2.2.3 below).

Apart from the Han Chinese, the other group which attempted to claim the island during this period was the Japanese. Japan regarded Taiwan as a base for trading with and invading China because of its geographical location⁹ (Lumley,

China (A.D. 1280-1368) later installed a local administrative official on the Pescadores (Wang, 1992: 28).

⁶ For discussion of Taiwan's economic history during this early period, see Davidson (1903); Wills (1972); Wu (1956: 89-188); Nakamura (1954: 54-69); Iwao (1955: 53-60).

⁷ Under the 'maritime prohibition policy', the administrative office in the Pescadores was abolished and the Han people were moved back to the Chinese mainland. For the sole purpose of eliminating pirates, Ming forces were sent as far as the Pescadores and Taiwan, but the only contact Ming had with Taiwan was thus occasional policing of the area (Ts'ao, 1980: 44-47; Hung, 1981: 25-34; Wang, 1992: 29).

⁸ Cheng Chi-lung appears in the records of the Dutch East India Company as a pirate chief who 'terrorises the whole of the China coast' (Lumley, 1976: 42).

⁹ During the sixteen century Japanese traders and pirates dominated the seas of Southeast Asia. Both forms of contact with Taiwan virtually ceased in the seclusion period (Hunter, 1989: 39).

1976: 42; Wang, 1992: 29). In 1598 the shogun of the Tokugawa dynasty sent Murayama, the governor of Nagasaki, to conquer the island.¹⁰ He landed at Keelung with a force of between 3,000 and 4,000 soldiers, but it appears that the indigenous population resisted and he failed¹¹ (Lumley, 1976: 42). However, the Japanese continued to trade with the Chinese mainland (despite a maritime prohibition operating in China) by smuggling transactions through Taiwan until the Bakufu¹² ordered the 'closing of Japan' (*sakoku*) in 1639 (Takekoshi, 1907: 49-53; Hung, 1981: 34-35, 60; Hunter, 1989: 40).

During the sixteenth and seventeenth centuries, Western powers began to penetrate to China by sea. In 1590, the Portuguese 'discovered' Taiwan, calling it 'Ilha Formosa', or 'beautiful island' (Ts'ao, 1980: 51; Shih, 1980: 52). Under this name, Taiwan was introduced to the Western world. After establishing a settlement in the northern part of the island the Portuguese left (Hsieh, 1964: 140).

Because of Taiwan's strategic importance with respect to trade with China and Japan, it became a target for control by the European maritime powers (Wang, 1992: 30). The Spanish came to Taiwan in 1626. They built forts at Keelung harbour (which the Spanish named 'Santissima Trinidad') in 1626 and Tamshui harbour (which the Spanish named 'Castillo') in 1629. The Spanish established administrative headquarters on the north-eastern part of Taiwan, which was not at that time occupied by the Dutch. In 1642, however, the Dutch drove them out. Among the European powers, therefore, it was to be the Dutch who had the most

¹⁰ For centuries Japan had a dual system of rule, comprising a reigning emperor based at Kyoto and a military government whose seat was normally outside the capital. Many of the military rulers were granted by the emperor the title of shogun (Hunter, 1989:3). Shogun is an abbreviation of *seii-taishogun*, meaning literally 'the great General who subdues barbarians' (Ibid: 14).

¹¹ Some historians assert that the Japanese failed to conquer Taiwan because Murayama's fleet encountered a typhoon (Wang, 1992: 30).

¹² The shogun presided over a military administration known as the Bakufu (Hunter, 1989: 3).

significant influence on Taiwan. The presence of the Portuguese and Spanish proved to be fleeting (Hsü, 1975: 54-59, 77-78; Hung, 1981: 50-56).

2.2.2 Taiwan's Economy During the Dutch Commercial Period (1624-1662)

The Dutch occupied Taiwan from 1624 to 1662¹³ in an attempt to gain a foothold in the China market,¹⁴ creating the first alien, colonial regime over the island (Wang, 1992: 31). At first, in 1622, the Dutch had occupied the Pescadores. That move aroused the opposition of Ming China, and the subsequent conflict was resolved in 1624 by an agreement that required the Dutch to abandon the Pescadores but allowed them to occupy Taiwan, accompanied by a mutual understanding that the Dutch would be permitted to trade with China (Beckmann, 1973: 34-36; Ts'ao, 1980: 56-57; Shih, 1980: 56-58). Because the Spanish had established another regime in northern Taiwan (1626-1642) and the Pescadores remained the jurisdiction of Ming China, Taiwan, as defined today, was simultaneously subject to three sovereigns.

The Dutch constructed forts at Tainan, on the southern Taiwan coast, as their headquarters (Hsü, 1975: 54). They controlled Taiwan through the vehicle of the Dutch East India Company, which not only was a trading organisation but also had the task of governing the island.¹⁵ The Dutch government gave the company full power to rule and tax the indigenous tribes and the Han Chinese on Taiwan (Hsieh, 1964: 141). Since the company was entrusted with diplomatic,

¹³ In fact, the Dutch occupied only the southern part of Taiwan in 1624. They extended their territorial claim to the northern part of Taiwan in 1642 (P'eng and Huang, 1976: 6).

¹⁴ The Dutch occupation of Taiwan was motivated chiefly by the prospect of mercantile profits, rather than an extension of territorial power (Angelino, 1931: 3). However, in light of evidence that the Dutch language was taught to the indigenous people and that education was extended to the women (Lumley, 1976: 42), it is possible that the Dutch might subsequently have intended a permanent occupation.

¹⁵ With a small number of personnel, the company's governor of Taiwan and his council exercised all administrative and judicial functions under the supervision of the East India government (the central government) in Batavia (Jakarta) (Beckmann, 1973: 45-47; Shih, 1980: 80-86).

administrative, judicial, and other functions of sovereignty by the Dutch government, in terms of international law the Dutch Republic exercised authority over Taiwan (Angelino, 1931: 2-3; Yanaihara, 1933: 316). Under the administration of the company, the island quickly became a trading centre for Dutch, Chinese, and Japanese merchants. No money was involved in these exchanges - transactions took the form of bartering. In trade with China, the Dutch used silver as money; the Dutch received the silver from Japan to whom they sold Chinese goods (Hsieh, 1964: 143).

Because the Dutch valued Taiwan primarily for its strategic location and the possibility of mercantile profits, little attention was paid to developing the island's resources. Agriculture was primitive, but sufficiently productive to create a small surplus, and some rice and sugar were exported. Besides farming, the other major economic activity was hunting, which supplied a flourishing trade in deerskins.¹⁶

The Chinese population in Taiwan more than quadrupled between 1624 and 1650.¹⁷ This indicates that a substantial number of Chinese moved to Taiwan during the Dutch period. Immigration during this period is perhaps not surprising, because at that time China was in the turmoil of a dynastic change, from the Ming to the Ch'ing. By contrast, the civil war between the Ming and the Manchus had enabled the Dutch to lay the foundations for their colony in Taiwan with the minimum of internal unrest (Lumley, 1976: 42).

¹⁶ With the extinction of the deer population in the latter part of the seventeenth century, this trade eventually came to an end (Nakamura, 1959: 24-42).

¹⁷ When the Dutch arrived in Taiwan, they reported a Chinese population (largely concentrated in the vicinity of Tainan) of 25,000 (Davidson, 1903: 13). In the 1650s the Chinese population in the Tainan area was about 100,000. Scholars assume that the figures probably underestimate the Chinese population in Taiwan at that time (Ho, 1978: 9).

In 1656 the Dutch reported that 7,187 hectares of land was cultivated.¹⁸ A significant proportion of that land was planted with sugar cane,¹⁹ exceeding the requirements of the island's population. This was because ocean-going vessels extended the market for sugar beyond the confines of the island. Therefore, even in this early period, some specialisation of production was evident (Iwao, 1955: 56).

Characteristically, colonial powers find that in order to make a profit from a colony, trade is more efficient than agriculture, and taxation is more effective still (Beckmann, 1973: 45-47; Shih, 1980: 80-86). Taxing the inhabitants of the colony involves little capital and no risk. The Dutch East India Company recognised this fact, and imposed heavy taxes on the people of Taiwan (Hsieh, 1964: 144). Before the Dutch arrived on the island, the Chinese in Taiwan enjoyed free trade with the Japanese and were untaxed. The Dutch established a tax on exports, at that time mainly on deerskins and sugar. Because of the tax, Japanese and Dutch relations deteriorated to the point that trade between the two countries was discontinued (Riess, 1897: 14-16).

The Dutch also imposed a land tax, varied in accordance with different grades of land.²⁰ In addition, the Dutch required Taiwanese people to pay fees for protection from attack by the indigenous tribes (Hsieh, 1964: 144). Moreover, every inhabitant, including Han Chinese and members of the indigenous tribes, who had reached the age of seven years had to pay a poll tax (Ho, 1978: 10). Apart from the taxes mentioned above, each hunter had to pay a license fee for hunting (Chow, 1956: 64). Other taxes were numerous: even fishermen were obliged to turn over a

¹⁸ Some scholars has suggested that this figure may be underestimated, since some cultivated land undoubtedly escaped the Dutch registration (Ho, 1978: 9).

¹⁹ The Dutch reported 1,573 out of 7,187 hectares of cultivated land was used for growing sugar cane (Tuan, 1992: 32).

²⁰ Farms were classified as upper, middle, and low grade by the Dutch (Ho, 1978: 9).

portion of their catch to the Dutch company and to pay fees on all shipments of fish out of Taiwan (Hsieh, 1964: 144).

During the late years of Dutch rule, as Dutch trade with China became difficult because of problems in acquiring merchandise from wartime China, Dutch interest in the island gradually decreased (Angelino, 1931: 5). In 1662, the Dutch were finally ousted from Taiwan by the Cheng forces (Beckmann, 1973: 56).

2.2.3 Taiwan's Economy during the Cheng Regime Period (1662-1683)

During the seventeenth century, when the Manchus invaded China and toppled the Ming dynasty, Taiwan became an island of refuge for patriotic Ming loyalists, led by Cheng Cheng-kung, who established the island's first (independent) Chinese government²¹ (TBMOC, 1991: 7). Cheng introduced Chinese laws and customs and the Chinese form of government and transplanted Chinese tradition to the island (Hung, 1981: 123-27, 177-79, 229-38; Hsü, 1975: 80). With Cheng came not only his army and its dependants, but also those who shared his political allegiance (Ts'ao, 1954: 76). Others were attracted by the inducement of free land and the exemption of land tax for three years (Davidson, 1903: 50-51; Kuo, 1954: 56-58).

When Cheng's regime ended in 1683, the Chinese population was estimated at between 200,000 and 350,000 (Ho, 1978: 10). Most of the immigrants probably came to Taiwan either with Cheng in 1661 or immediately after his arrival, because in later years the Manchus ordered the withdrawal of all mainland inhabitants living

²¹ Although Taiwan was claimed by the Chinese in 1430 during the Ming dynasty, Taiwan was not part of one of the provinces of China until the Ch'ing dynasty. Also, there was no Chinese government in Taiwan until 1662. The struggle between the Ming dynasty and the Manchu forces ended with the establishment of the Ch'ing dynasty in 1644. Cheng Cheng-kung and his army of 25,000 represented the last major force still loyal to the Ming dynasty (Ho, 1978: 10). However, the Ming government no longer existed in China when Cheng's forces attacked the Dutch on Taiwan in 1661. Therefore, after 1662 the Cheng government became, *de facto*, the supreme authority on the island. Subsequently, Taiwan was recognised as an independent state by Europeans (P'eng and Huang, 1976: 9-10, 23; Hsieh, 1964: 151).

within ten miles of the coastline toward the interior in order to prevent Cheng from receiving supplies and other assistance (Ho, 1978: 10; Hsieh, 1964: 152). Emigration to Taiwan from the Chinese mainland was also prohibited.²²

During Cheng's regime, the development of agriculture was emphasised in order that the island should become self-sufficient in food. Koxinga (as Cheng is known in the West) quartered his troops with farmers, explaining that in peace soldiers would work on the land. It may be claimed that Koxinga's soldier-farmer policy laid the essential foundation of Chinese colonisation in Taiwan, just as in the 1950s Chen Cheng's 'Land to the Tiller' policy formed the basis for Taiwan's present economic strength (Lumley, 1976: 44). During the period of rule by the Cheng Cheng-kung family, the farm tax was kept at the same level as that imposed by the Dutch, even though Cheng's time saw improved methods of cultivation and increased production. A poll tax was collected from whoever reached the age of ten years (Ho, 1978: 11). The taxes imposed by the Cheng family were still considered too high by the Ch'ing dynasty when it later took over the island (Hsieh, 1964: 144, 152).

The Han Chinese on Taiwan, unlike those in China, did not despise the West and thus maintained a pragmatic relationship with European powers.²³ Manufacturing was also promoted during Cheng's regime. Sugar refining was encouraged, and the manufacture of tiles began. Instead of the traditional baking method, a sun-drying method was used; this laid the foundation for a salt production industry on the island. Some shipbuilding was initiated (Hsieh, 1964: 152). Brisk trade was carried on with neighbouring areas. Under Cheng's efficient

²² And, in practice, made difficult as well as illegal by the Manchu maritime prohibition of 1656, which obstructed travel to Taiwan (Wang, 1992: 34).

²³ The traditional Chinese regarded Westerns as 'barbarians' and considered that international trade should be subsumed under the tributary system (Hung, 1981: 208-210). After Ch'ing China conquered Taiwan in 1683, Taiwan's prosperous international trade ended (Hsü, 1975: 102).

administration, the foundations for Taiwan's later economic development were established.

In 1683, the Ch'ing dynasty government attacked Taiwan, and the ruler Cheng Ko-shuang, the grandson of Cheng Cheng-kung, unconditionally surrendered to the Manchus (Ch'ing dynasty) (Ho, 1978: 10; Hsieh, 1964: 153). The Cheng family regime lasted from 1662 to 1683, only one-tenth of the time covered by the Ch'ing dynasty, which ruled on Taiwan from 1683 to 1895. During the Cheng period, because of hostility between the Ch'ing and the Cheng Taiwan was effectively an independent state; under the Ch'ing dynasty Taiwan was part of Fukein province in China (Hsieh, 1964: 151).

2.2.4 Taiwan's Economy in the Ch'ing Dynasty (1683-1895)

From 1683, when Taiwan was incorporated as a prefecture of the Chinese empire, until 1895 when it was ceded to Japan, the island remained under the rule of the Ch'ing dynasty. Taiwan experienced a significant degree of economic change in the eighteenth and nineteenth centuries. During this period, the traditional agricultural mode of production that existed in mainland China was gradually reproduced in Taiwan as thousands of Chinese migrated, sometimes illegally, to the island.²⁴

The Chinese immigrants were either seasonal workers from Kwangtung or permanent settlers from the southern coast of Fukien (Tuan, 1992: 38-39). The arrival of these settlers provided Taiwan with the additional manpower needed to exploit its natural resources. In 1811, when each household was required by the

²⁴ Unrest and revolt in Taiwan would sometimes lead the Manchus to prohibit migration from mainland China to Taiwan (Tai, 1979: 274). Until 1760 immigrants were not allowed to bring their families. On occasion they were given permission to send for their families once they became settled (Wang, 1992: 43-44).

pao-chia system²⁵ to register its members, a Chinese population of 2,003,861 was recorded (Ho, 1978: 11).

Although Chinese agricultural techniques were traditional, their introduction to and adoption by Taiwan in the eighteenth and nineteenth centuries was undoubtedly a major development in Taiwan's economic history. At the same time, the traditional approach was not conducive to technological change, and productivity increased only slowly in the Ch'ing period (Myres, 1972: 373-75). Despite this, the Chinese immigrant farmers still generated a small surplus for export.

Sugar, as an export item, was more significant than rice. It is common knowledge that in the Ch'ing period Taiwan supplied north China with sugar and that substantial quantities were also exported to Japan. The crushing of cane was done by stone rollers in primitive mills, of which 1,400 existed in the nineteenth century (Myres, 1891: 16). The sugar industry remained in a primitive state until the Japanese modernised it with new production techniques and mechanisation in the early decades of the twentieth century. Sugar forfeited its position as leading export to tea in the 1870s, and indeed for much of the last half of the nineteenth century the level of activity in the tea industry determined the general economic prosperity of the island. Unlike sugar, the tea industry developed as a direct consequence of the opening of trade with the West (Myres, 1891: 18): in 1866, John Dodd, a British trader, was successful in producing oolong tea in Taiwan that was acceptable on the world market (Ho, 1978: 21).

Until the last half of the nineteenth century, Taiwan's external trade was solely in the hands of Chinese merchants, operating largely from Amoy.²⁶ The legal

²⁵ The *pao-chia* system is a mutual responsibility scheme for holding both the village and the family responsible for the conduct of their members.

²⁶ Amoy is situated opposite Kinman and is part of Fukien province.

exclusion of foreign merchants from Taiwan ended in 1858, when the Treaty of Tientsin²⁷ designated Anping as a treaty port. Subsequent treaties forced other Taiwanese ports open to foreign trade.²⁸

The Manchu (Ch'ing) government, consistent with its behaviour in other parts of China, showed little interest in developing or modernising Taiwan. The only significant attempt by the government to promote economic development came toward the end of the nineteenth century. In 1887, the Manchu government altered its attitude toward the island, in response to the French threat to Taiwan,²⁹ and elevated it from a prefecture to a province (Chang, 1980: 233- 35). Liu Ming-ch'uan was appointed Taiwan's first governor. Instead of being prohibited or passively allowed, immigration was actively encouraged. During this time the area of cultivated land on the island expanded northward, where previously it had been confined to the south (Hsieh, 1964: 153-154). The seven years of Liu's administration (1884-1891)³⁰ represented the first and only serious effort by a Ch'ing official to modernise the island³¹ and to provide it with the bare minimum of infrastructure needed for economic development. Numerous ambitious economic projects were initiated by the governor (Chu, 1963: 37-53), but all Liu's projects were eventually concluded successfully only later by the Japanese (see Chapter 3

²⁷ The Treaty of Tientsin were concluded at Tientsin, China, June 26-29, 1858, between China on one side, and the United States, Great Britain, France, and Russia on the other. Under its terms China opened eleven more ports in addition to those opened on the mainland under the Treaty of Nanking (1842); permitted legations at Peking; allowed trade; and permitted Christian missions to the interior of China (Hertslet and Parkes, 1908: 86- 97).

²⁸ In 1860 the Treaty of Peking opened Tamshui as a treaty port, and three years later Keelung was added as a supplementary port to Tamshui and Takao (present day Kaohsiung) and as a supplementary port to Anping (Hertslet and Parkes, 1908: 112-114).

²⁹ The French landed in Indo-china in 1859, and in 1884 proposed the occupation of Taiwan following the peace treaty at the end of the Franco-Chinese war (Lumley, 1976: 45).

³⁰ From 1884 to 1887, Liu, then the governor of Fukien, administered Taiwan as a prefecture of Fukien.

³¹ Through Liu's efforts Taiwan was to build the first railway in China (Lumley, 1976: 46).

below). The lack of political and financial support from Peking was probably the main reason for Liu's failure.

Chapter 3

Capital Inflow and Economic Development in Taiwan During the Japanese Colonial Period, 1895-1945

This chapter focuses on Taiwan's economic development during the Japanese colonial period, 1895-1945, and the manner in which the Japanese colonial government operated Taiwan's economy.

Japanese imperialism rose in the second half of eighteenth century at a time when the Ch'ing dynasty in China was confronted by large-scale uprisings within China. Internal disorder severely crippled the capacity of the Ch'ing empire to cope with the growing strength of the foreign countries surrounding China. When the Ch'ing rulers lost the Sino-Japanese war, Taiwan became Japan's first colony. The Japanese had no intention to develop Taiwan's industry. In order to fulfil the economic slogan of 'an agricultural Taiwan and an industrial Japan', the Japanese intensified Taiwan's agriculture and improve its relevant infrastructure. The majority of capital inflow during this period was from Japan. It played a crucial part in developing Taiwan's production infrastructure, which was later to help Taiwan's post-World War II recovery and industrial development, to be discussed further in Chapter 4.

3.1. The Rise of Japanese Imperialism and the Japanese Occupation of Taiwan

The distinctive nature of Taiwan's colonial experience can be traced back to the unique features of Japanese capitalism and imperialism and the ways in which they impacted on Taiwan. The origins of Japan's imperial ambitions lie in Western

imperialism,¹ of which Japan was itself a victim (Myres and Peattie, 1984; Cumings, 1984: 1-40). During the nineteenth century, the European and American Powers had forced China and Japan to sign unequal treaties ceding extraterritorial rights and controls over Chinese and Japanese tariffs.² However, the Japanese response differed from that of China. In 1868 the Japanese overthrew the 250-year-old Tokugawa shogunate and restored the Meiji emperor, thus ending Japan's 200-year commitment to an isolationist policy (Allen, 1963: 29). Their overriding goal was 'national wealth and military strength' (*fukoku kyoehi*) in order to retain independence and to achieve security. Internal development and full independence were intertwined objectives (Gold, 1988b: 102).

¹ Gold (1988b: 102) has argued that it would be an error to explain Japanese imperialism by a simplistic application of Lenin's (1939) analysis of Western imperialism. Lenin asserts that imperialism is first an economic phenomenon: international monopoly-capital "colonises" the world through markets, investments and materials; State action comes afterwards. Gold has claimed that in the case of Japan, the two phases occurred simultaneously. The initial impetus behind Japan's imperialist activities was not only economic but also political. Capitalism in Japan was still fragile, owing to the economy's shortage of materials, capital and technology, when the nation embarked on imperialist ventures.

² In the Treaty of Aigun of 1858, the Ch'ing government signed away the *Wu-su-li* (Ussuri) area to the Tsar (Halliday, 1975: 16). In 1875 Russia and Japan signed a treaty under which Japan renounced its claims to any part of Sakhalin in return for possession of the Kurile Island (Amidon, 1959). British attempts to force China to allow British merchants to sell opium in China led to the First Opium War of 1840-42 (Halliday, 1975: 16). Ch'ing China lost the war and was obliged to sign the Treaty of Nanking (1842). The treaty compelled China, among other things, to open five ports to British trade, to extend official recognition and diplomatic relations on an equal basis, and to pay reparations (Article II, III, IV, V and VI of the Treaty). After the granting of privileges to Britain in China, other Western countries made similar demands. The Ch'ing government responded to these demands by signing treaties which provided foreign countries variously with leased territories, or extra-territoriality, or foreign control of custom tariffs, or the exercise of foreign authority over Chinese territories (Hsieh, 1985: 9). These were the so-called 'unequal treaties' which the Chinese subsequently sought to annul over about half a century. Most of the unequal treaties were abolished as the result of the Second World War, in which China was one of the Allies. The United States and Britain abolished their extraterritorial jurisdiction in China, in accordance with their treaties with China dated 11 January 1943 (Hsieh, 1985: 22- 23).

In 1854 American Commodore Perry had forced Japan to open two ports to Americans (Lumley, 1976: 45). There were the first Japanese treaties with Western powers (Halliday, 1975: 18). Agreements similar to Perry's followed with other powers. The 'opening of the ports' came in 1858, when Japan was obliged to sign unequal economic with the United States, followed in rapid order by Holland, Russia, Britain and France. These treaties exposed Japan to foreign trade on very unfavourable terms (Halliday, 1975: 17).

Analysing the primary sources of Western power, Japan's new leaders undertook a thorough restructuring of the nation's political and social system. Central to this project was economic development, particularly industrialisation. In the absence of an indigenous capitalist class, the Meiji state itself set goals for capital accumulation, investment, and production. After establishing several new enterprises, it sold some of them off to local private investors, most of whom were large bankers (Hirschmeier, 1964).

The need for raw materials to fuel its growing industry and population was one impetus for Japan's abandonment of isolationism. It appears, however, that there was no similar search for foreign investments and markets in order to resolve problems of capital surplus and a falling rate of profits. Other, primarily political and military, reasons offer better explanations for Japan's change of orientation (Duus, 1984: 125-71). Japan wanted to establish a cordon sanitaire, which included Korea and China, against Western imperialists (Gold, 1990: 33). It was also determined to demonstrate to the West that it was a power to reckon with; Japan had successfully industrialised and militarised and felt it deserved to be treated as an equal. Further, it wanted to regain sovereignty and tariff autonomy.³ Establishing overseas colonies, as the Western powers had done, would be convincing proof of its achievements. There was also an element of missionary zeal in this: Japan would teach other Asians the benefits of modernisation (Takekoshi, 1907).

Few areas of the world remained to be colonised, and Japan was not in a position to wrest a colony from a Western power. However, Japan could gain territories nominally controlled by its weak neighbour, China. Thus Japan's colonial ambitions focused on Taiwan, Korea and Manchuria (Gold, 1988a: 102).

³ Although Japan was not colonised by any of the Western powers, between 1853 and 1868 various Western powers forced the Bakufu (central government) to enter into diplomatic relations and to open major ports to trade. The Western powers also landed several thousand troops in Japan and engaged in a number of sizeable military operations, including the opening of the Straits of Shimonoseki in 1864 (Halliday, 1975: 18).

By 1895, Taiwan was ripe for Japanese conquest. The Japanese regarded the island as an independent territory separate from mainland China, which indeed had been ruled briefly by the Japanese in the past (Wu, 1990: 270-72; Mukoyama, 1987: 15-18). In 1874, the Japanese had sought to take Taiwan from China, and had forced China to make explicit its then vaguely-formulated claim to the island (Long, 1991: 23; Gold, 1990: 33).

The first Sino-Japanese war over Korea broke out in 1894⁴ (Allen, 1963: 170). China was engaged in putting down a rebellion in Korea, which it still treated as a tributary. Japan joined the war, notionally to protect Korean independence but in reality to further its own interests in Korea and China (Long, 1991: 23-24; Gold, 1990: 33). The war was fought at sea and in Manchuria, and ended in the defeat of Imperial China (Ho, 1978: 91). Following the negotiations that ensued at Shimonoseki, the Ch'ing government ceded Taiwan to Japan⁵ (Lumley, 1976: 47). For the next fifty years, Taiwan was a Japanese colony.

The Japanese colonisation of Taiwan differed from the earlier phase of Dutch colonisation in a number of ways. First, the Dutch colonised Taiwan in the seventeenth century for immediate commercial profit; political sovereignty was only a secondary consideration. The Japanese, by contrast, considered political control to be more important than commercialisation. Secondly, Protestant missionary clergymen played a central role in administration during the Dutch period. The policeman, however, was the most important figure in the fulfilment of colonial aims during the Japanese period. Thirdly, the Dutch authorities paid more

⁴ Japan declared war against China on 3 August, 1894, and a British Proclamation of Neutrality was issued on the 7th of the same month (Parry, 1979: vol. 181: 217).

⁵ In the peace agreement formalised as the 'Treaty of Shimonoseki' of 17 April 1895, Japan secured recognition of Korean independence (Article 1), the opening of four more treaty ports (Article 6), the right of Japanese nationals to build factories in China (Article 6), a sizeable indemnity (Article 4), and the cession of Taiwan, the Pescadores, and the Liaodong Peninsula to Japan (Gold, 1990: 33; Long, 1991: 24; Parry, 1979: vol. 181, p. 217- 224; MacMurray, 1921: 18).

attention to Taiwan's exports than to her imports. In the Japanese period, however, Taiwan's trade was centred on imports of manufactured goods, and on the export of agricultural raw material to Japan. Fourthly, during the Dutch colonial phase foreign trade was mainly in 'goods', in contrast to the Japanese period when that trade was centred on 'capital' (Hsieh, 1964: 162).

Over the course of five decades, the Japanese effected profound changes in Taiwan. As Ho (1978: 25) has stated, "The transition from a neglected Chinese province to a Japanese colony in effect turned Taiwan from an essentially closed to an open economy, and economic development was a consequence of this opening-up process." Most importantly, the Japanese colonial government, with objectives vastly different to those of the Imperial Chinese government, was actively involved in developing the island. Under colonialism, Taiwan experienced a period of steady growth (Ho, 1978: 26). In the light of its continued growth after World War II, Taiwan's economic development under Japanese may seem less significant. But, even today, many less-developed countries have not been able to sustain a growth rate comparable to that achieved by colonial Taiwan. The rate of growth achieved by Taiwan during the colonial period was a major advance upon its earlier pattern of development (Ho, 1978: 26-28).

3.2. Industrialisation during the Japanese Colonial Period

The colonial occupation of Taiwan can be divided into four stages, each covering approximately a decade. The first decade of Japanese rule was spent in pacification, the next four decades in modernisation.

3.2.1 Initial Measures

During the first stage of modernisation (i.e., the second decade), the Japanese made a land survey, standardised the measurement and money systems,

brought under government monopoly the manufacture and sale of a number of important products, introduced strict police control, began collecting census data, and made an ethnological study of the indigenous inhabitants. The first four measures, in particular, helped to create a stable base for subsequent economic development.

In order to administer land taxes effectively, the clarification of land ownership throughout the island was essential (Tu'an, 1992: 62; Hsieh, 1964: 163-164). The Japanese established a land survey bureau to carry out this policy. After the survey was completed, the unit of land measurement was standardised, land ownership was clarified and tax collection became efficient. The survey was not limited to the agricultural land, but included forested areas also. As a result of the survey, the Japanese authorities gained precise data necessary for economy planning. In general, the Japanese authorities did not confiscate any land which they required, but paid large sums for it. By the end of the Japanese period, ownership of nearly 80 per cent of cultivated land and nearly 95 per cent of forested land in Taiwan lay in the hands of the Japanese government (Hsieh, 1964: 164).

The Japanese policies of standardising the measurement of commercial goods and of setting up a money system were designed to promote the goal of Japanisation (Tu'an, 1992: 62-63). During Chinese rule, units of measurement had differed from place to place in Taiwan. In 1895 the Japanese system of measurement was introduced, and in 1911 the Japanese currency was adopted (Hsieh, 1964: 164).

In order to increase its revenues, the Japanese monopolised industries producing salt, camphor, opium, tobacco, and alcoholic beverages in Taiwan. These monopolies were responsible for two-thirds of the Japanese income from Taiwan (Hsieh, 1964: 164).

The investigation of land ownership in Taiwan, standardisation of measures and money, and the monopolies assured over certain products all depended on the colonial government, especially on the police. The Japanese installed the *hoko* system of local committees, based on the traditional Chinese ‘pao-chia’ system⁶ (Long, 1991: 27). The *hoko* system demanded joint responsibility from every 100 households to prevent crime, organise community services and to prevent subversion (Ch’en, 1970: 144-48). Although *hoko* members were Taiwanese, the Japanese police were able to keep a close watch on the elected leaders (Gold, 1988a: 103). The police had a great deal of power, and were central to Japan’s success in controlling Taiwan. They were charged not only with keeping order, but also with assigning permission to cultivate certain crops, arranging for the use of irrigation facilities, recruiting soldiers, collecting taxes, conducting censuses, employing labour for road-building, and supervising work (Hsieh, 1964: 163).

3.2.2 The Second Stage - Expansion of Transportation in Taiwan

As a corollary of industrialisation, it was essential to increase Taiwan’s transportation facilities. The government subsidised a steamship company, which operated a line between Taiwan and Japan. Later the company operated additional lines to other parts of Asia, and in time a second company entered the shipping business. Recognising their importance to Taiwan’s economy, the Japanese modernised the island’s seventeen harbours (Gold, 1990: 36).

Nearly a decade before the Japanese took over Taiwan, the Chinese built a 62-mile railroad in the north. The Japanese government built a new, 250 miles line, connecting the two largest ports, Keelung on the northern coast with Kaohsiung on the south-western tip, and passing through a number of other major cities (Hsieh, 1964: 165-166; Gold, 1990: 36).

⁶ ‘Pao-chia’ is a conventional Imperial Chinese method of control in which ‘neighbourhood’ committees act as the state’s eyes and ears at a grassroots level.

The construction of highways in Taiwan was begun by a Japanese expeditionary army. The first highway was completed in 1913. At the end of the Japanese period, Taiwan had about 2500 miles of highway (Hsieh, 1964; 167).

3.2.3 The Third Stage - A New Irrigation System and the Intensification of Agriculture

In the development of Taiwan's agriculture, the key to overcoming the handicap of uneven rainfall has been irrigation. The Japanese provided that key when they began to use cement for building dams. The Japanese started to build the Chia-nan irrigation system in 1920 and completed it in 1930. This irrigation system converted 67,050 acres of poor land, which previously had suffered from floods and drought, into the most fertile farmland of the country. The reservoir constructed as part of the system was sufficient to irrigate about 457,000 acres of land, and was one of the largest reservoirs in the Far East (Hsieh, 1964: 168-169).

After the system became operative, the land used for growing rice increased by more than 74 per cent, and that used for producing sugar-cane by 30 per cent (Sun, 1956). With irrigation the production of rice per unit area nearly doubled, and the total rice production increased more than three times (Hsieh, 1964: 171). The value of sugar cane production per unit area almost tripled and the value of its total production rose more than 300 per cent (Hsieh, 1964: 170). This intensification of Taiwan's agricultural production was a deliberate Japanese policy, undertaken for the sake of Japan's own interests.

(A) Rice

The Japanese not only built an irrigation system; but also, with the intention to feed Japan's large population, they established new agricultural experimental stations and paid small subsidies to new rice producers. On the basis of the increase in both acreage and production, one might conclude that Taiwanese farmers were

much better off than they had been before. They were certainly more productive. However, as Gradjdanzev (1942: 54-56) has pointed out, the actual cost of production was more than 33 per cent higher. The farmer increasingly needed money to pay taxes and to defray the cost of irrigation and fertilisers. Thus the additional wealth they generated was not retained by the agricultural industry.

(B) Sugar

The huge increase in production of sugar cane and the development of the sugar industry are considered two of the most spectacular achievements of the Japanese occupation of Taiwan. A special sugar bureau was established in 1902, and at the same time a sugar industry encouragement ordinance was promulgated. The Japanese government granted subsidies to encourage the industry. Within 30 years (1905-1935), the sugar-cane producing area increased almost five-fold, the total production thirteen-fold, and the yield per acre went up by a factor of two and four-tenths (Hsieh, 1964: 173). Apart from irrigation, much of this increase was attributable to World War I, and the consequent increase in demand for sugar. During the war the Japanese increased the area used for the cultivation of sugar cane in Taiwan to more than six times that in 1902.

3.2.4 The Fourth Stage - Industrial Development

In accordance with the Japanese policy of 'An agricultural Taiwan and an industrial Japan', the Japanese did not at first seek to develop Taiwan's industry to any great degree. Initial advances were mainly in the area of sugar refinement. Other activities followed in time, however, and by 1939 the gross production levels of industry and agriculture were about equal, with industry slightly ahead (PDAF, 1950: 30-31).

At the beginning of the Japanese period only 24 factories existed in Taiwan; 30 years later the number had risen more than fifty-fold (Hsieh, 1964: 177). In the

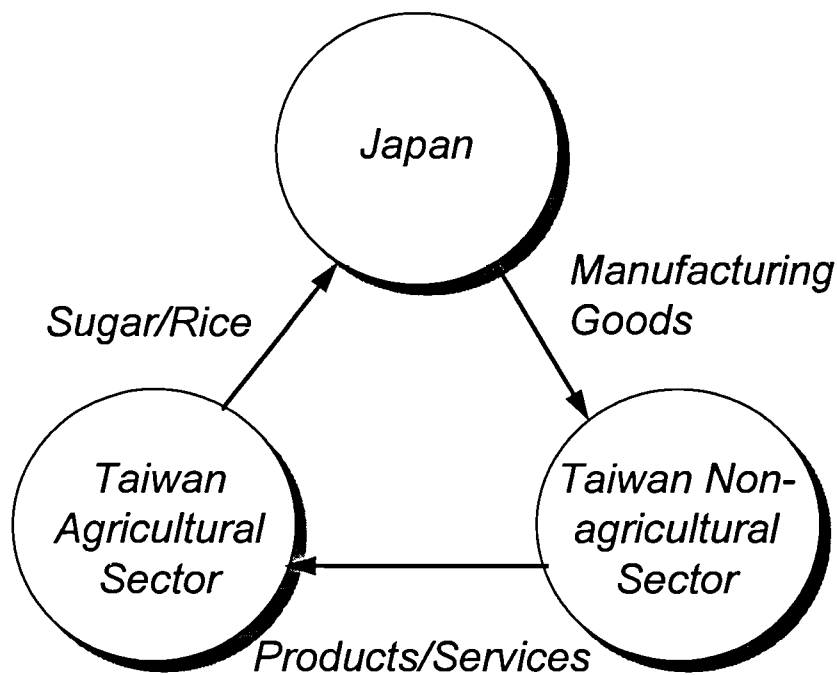
following decade that figure itself nearly tripled. However, the factories were in general small. Not until World War II compelled the Japanese to develop the island's chemical, metal and other strategic industries did Taiwan's industries become major operations (Chow, 1958: 68).

Long before World War II, the Japanese realised that the key to the island's industrial development was cheap hydroelectric power. A project was devised in 1931 for the utilisation of Sun Moon Lake, and the Cho-shui River which drains it, to generate power (Hsieh, 1964: 177). The Sun Moon power plant is perhaps the greatest achievement of the Japanese in Taiwan. With it the Japanese laid the foundation for further industrialisation of the island, by creating the capacity to support aluminium, chemical, and steel alloy plants.

3.3. Japanese Economic Strategy in Taiwan during the Colonial Period

It is useful to think of Taiwan's colonial economy as comprising two sectors: agriculture and non-agriculture. The strategy of the colonial authorities was to develop Taiwan in order to complement Japan; thus emphasis was placed on the economic integration of the two territories. The practical effect of this was that Taiwan became an agricultural appendage of Japan, helping to feed its growing industrial population. The agricultural sector produced and exported sugar and rice to Japan (Allen, 1963: 111). Japan, in turn, exported manufactured (consumer and capital) goods to Taiwan's non-agricultural sector. Taiwan's non-agricultural sector then used these imported goods to generate industrial products and commercial services for Taiwan's agricultural sector. We can represent the economic structure as follows:

Figure 3.1 Japanese Triangular Model



The economic objective of the this triangular mode of operation was for Japan to extract from Taiwan what Paauw and Fei (1973: 5) have termed an “export surplus”, i.e. “the surplus from exports over and above imports required to maintain the existing level of production”. Part of the surplus was reinvested to increase Taiwan’s productive capacity, but much of it was transferred to Japan (Ho, 1978: 32).

Taiwan’s triangular mode of operation, and its success in generating an “export surplus”, are evident from its trade statistics. Nearly all Taiwan’s exports were primary products, such as rice and sugar (see Table A). Between 1900 and 1939 Taiwan’s export volume increased more than 18-fold, and by the late 1920s Japan was already absorbing 80-90 per cent of this growing trade (PBAS, 4-11; DG: The Annual Taiwan Trade Statistics; GI: The Trade of China). Imports increased less rapidly, but a preponderant share of them also came from Japan: 68

per cent in the 1910s and 1920s, and over 80 per cent in the 1930s (*ibid*). However, up to 70 per cent of Taiwan's imports were industrial in nature, and nearly all were supplied by Japan (see Table 3.1).

The strength of the economic bond between Taiwan and Japan, and the significance of one to the other, are best seen by examining Taiwan's two major export items, rice and sugar.⁷ Taiwan was Japan's major supplier of sugar. Nearly all Taiwan's rice and sugar exports went to Japan. In every year over 90 per cent of Taiwan's sugar output was exported, and in the 1930s it provided nearly 75 per cent of the sugar consumed in Japan (Lockwood, 1954: 536). As Taiwan was densely populated and because rice was its staple food, it was in a less favourable position to supply rice to Japan on a large scale. Nevertheless, in the 1930s about half of Taiwan's rice output was exported to Japan, accounting for over 30 per cent of Japan's import requirements (Ho, 1978: 31).

Taiwan was an economic asset to Japan not only because it was a source of food and raw materials, but also because Japan was able to obtain Taiwan's primary products without exchanging an equivalent value of manufactured goods. Except for the first decade of its occupation, Taiwan exported substantially more than it imported (Ho, 1978: 31).⁸ Because Taiwan's trade was mostly with Japan, the export surplus was essentially to Japan's advantage.

⁷ These two commodities, by value, accounted for 50-70 per cent of Taiwan's total exports in the colonial period (Ho, 1978: 31).

⁸ From 1916 to 1944 Taiwan's export surplus as a share of its exports averaged 26 per cent (*ibid*).

Table 3.1: Comparison of Exports and Imports, 1900-39⁹**(Annual averages as percentage of total)**

	1900-1909	1910-1919	1920-1929	1930-1939
EXPORTS				
Food	76.2	77.3	82.9	84.5
Rice	23.2	14.5	19.1	25.9
Sugar	27.8	50.6	50.6	46.8
Other	25.2	12.2	13.2	11.8
Other primary products	21.2	11.5	9.7	8.7
Mfg. misc. products	2.6	11.2	7.4	6.8
IMPORTS				
Food and other primary products	29.2	28.2	31.4	34.1
Mfg. misc. goods	70.8	61.8	58.6	65.9

3.4. The Colonial Government and the System of Economic Control

Economic growth in the colonial period was initiated and sustained through government efforts. Besides maintaining stability and order, and importing the intermediate goods which are so vital for economic development, the colonial government also introduced several economic programmes designed to promote development through its fiscal instruments and the preferential treatment of Japanese investors. As well as all this, the government influenced income distribution and ensured that the 'export surplus' generated by the economy remained in Japanese control (Ho, 1978: 32).

⁹ Source: Taiwan Government-General, *The Annual Taiwan Statistics*. 1937 and 1938 are excluded because trade data for these years are incomplete.

The colonial government had two principal economic objectives: (1) to promote the production and export of sugar and rice and (2) to keep economic power in Japanese hands. These objectives followed from the government's commitments to developing Taiwan's economy to complement Japan's, and to making colonisation 'profitable', by generating an ongoing export surplus. In practice, they meant the government was committed to making the triangular mode of operation work and be profitable for Japan. Much of what the Japanese colonial government did in Taiwan can be explained, directly or indirectly, in terms of these objectives (Ho, 1978: 32; Ranis and Schive, 1985:88).

The Government-General (*Sotokufu*) was the island's foremost investor during the colonial period. On average it allocated 40 per cent of its total current expenditures to capital formation. This amounted to 20 per cent of the exhaustive expenditures of all levels of government. The largest share of fixed capital went to transport and communications (Taiwan Government-General Statistic Book). Next in importance was its direct investment in agriculture (Ho, 1978: 35).

Besides promoting agricultural production and exports, the colonial government's second concern was to keep economic power in Taiwan under Japanese control. Both openly and covertly, the government encouraged the concentration of economic power in the corporate sector and tried to ensure that this sector was owned and controlled by Japanese. The most effective way for Japan to maintain Taiwan's dependence was to cut Taiwan's trade relations with other countries. The most convenient means to this end was to increase the customs duty on Taiwan's trade with other countries. In 1910 the Japanese abolished the customs barrier between Japan and Taiwan, and at the same time raised Taiwan's trade tariffs on imports from third parties (Chang, 1951: 60). It is worth noting here that between 1897 and 1944 there were only 12 years in which imports exceeded exports; there were 36 years in which exports outstripped imports. Imports from Japan were handled by the Japanese, but exports from Taiwan to Japan were also

monopolised by the Japanese. Thus the native inhabitants of Taiwan in practice had no foreign trade, only trade within the island and with Japan.

The sugar companies which dominated Taiwan's corporate sector were well-supported by the colonial government. In 1905, by government decree, the sugar-producing areas in Taiwan were divided into supply regions, with each region assigned to a refinery. The effect of the decree was to confer monopolies on the sugar companies. In 1909, the colonial government encouraged the formation of a sugar cartel, known later as the *Taiwan Sugar Association*, which was given the power to regulate the industry. The government supported this arrangement by restricting the expansion of existing factories and the construction of new refineries. With these privileges, the monopolistic structure of the industry was guaranteed. The cartel arrangement suited both the sugar companies and the government. Sugar companies were able to maximise their joint profits and the government, by allowing the cartel to exist, was in a strong position to influence and control the industry. At times, even such internal financial decisions as the size of dividend payments could not be made without government approval (U.S. Department of Navy, 1944a). More importantly, in macroeconomic terms the government was able to exploit a monopolistic industrial structure more easily to influence the size of the export surplus and the savings ratio.

The emergence of an indigenous industrial class in Taiwan was never encouraged; in fact, Japanese policy was to discourage its appearance. Until 1924 Taiwanese were not allowed to organise or operate corporations unless there was Japanese participation (Chang, 1955: 96). Even after this restriction was rescinded, Taiwanese were reluctant to seek entry into the corporate sector because of its domination by Japanese companies. Thus the sector continued to be monopolised by Japanese interests. Through its power to regulate and license, and by granting exclusive privileges to Japanese companies, the government successfully kept economic power away from the Taiwanese.

3.5. Capital Inflow during the Japanese Colonial Period

Capital for Taiwan's industry came initially from Japan. However, as the economy developed, it was financed increasingly from within the island. The flow of capital from Japan to Taiwan's non-agricultural sector was most important in the decade immediately after Japan took control. It is uncertain how much capital moved from Japan to Taiwan in this early period, but the balance of merchandise trade is indicative of the magnitude. Apart from 1913, Taiwan did not have an annual trade deficit after 1908. But between 1897 and 1908, Taiwan incurred a total deficit of 34.5 million yen (*Annual Taiwan Trade Statistics*).

That a substantial amount of Japanese industrial capital moved into Taiwan before 1910 is suggested also by other evidence. Between 1900 and 1906, the colonial government issued 25 million yen of par value bonds, nearly all of which were absorbed by Japan. More than half the receipts from government bond sales were used to construct the railroad network in Taiwan (Huang, Chang and Lee, 1951). Initially, Japanese were attracted to invest in Taiwan's sugar industry by the government's promise of a guaranteed dividend of 6 per cent on their investments. Subsequently, high profits in the sugar industry attracted further investment, so that by 1910 five of the six major sugar companies that were to dominate Taiwan's manufacturing sector had been established. It is not known how much Japanese capital went into these private ventures, but it was probably in the order of 20-30 million yen. The first fully modern sugar refinery was constructed and equipped in 1901 at a total cost of 850,000 yen (Davidson, 1903: 453). By 1910 there were fifteen modern refineries. Altogether, from 1896 to 1910, it is estimated that around 80 million yen of Japanese capital flowed into Taiwan (Ho, 1978: 84).

The Sotokufu offered financial inducements to solicit direct investment by Japanese companies on the island. After the turn of the century, and especially

following the stimulus provided by the defeat of Russia, private corporations began actively to invest, particularly in sugar refining (Chang and Myres, 1963: 443-44).

Japanese law was applied as far as possible in Taiwan during the colonial period, although the Governor-General retained the power to modify and limit its applicability (Gold, 1990: 41). The Sotokufu used its legal power to protect the interests and dominance of Japanese investors and to circumscribe Taiwanese participation in the developing industrial sector. By more or less tying peasants to the land, and by coercing them into providing sugar cane at fixed prices to specified mills, it guaranteed a steady supply of raw materials to Japanese refineries. Further, through limiting the number of mills that could be set up in a geographical area, it protected existing investors, usually Japanese. In the industrial sector, Executive Law No. 16 prohibited companies that only had Chinese investors from using the word *kaisha* (company) in their name (Gold, 1988a: 106). This meant that purely Taiwanese firms had to maintain antiquated forms of ownership and management, whereas modern companies were required to have a significant Japanese presence (Shih, 1980: 316). This law was abolished in 1924. Table 3.2 illustrates the results of the law: the overwhelming dominance of Japanese interests in companies limited by shares, i.e. the bulk of the industrial sector. Once Japanese corporations began to invest in Taiwan, their sheer magnitude and state-backed economic power was so great as to make effective Taiwanese competition highly unlikely. Therefore, even though the rules for establishing companies were liberalised in 1923 (facilitating entry of Taiwanese entrepreneurs into the modern sector), Taiwanese companies remained subordinate to Japanese business. Moreover, the indigenous entrepreneurs continued to be prevented from forming joint venture companies without Japanese participation, since such companies were required by law to have Japanese partners (Chang, 1955: 74-128; Ranis and Schive, 1985: 89). For these reasons, the traditional Chinese-owned sugar mills were quickly wiped out (Chang and Myres,

1963: 445). And any 'Taiwanese' firm of consequence was in reality controlled by Japanese.

Investment by countries other than Japan was negligible during the colonial period. Two American firms maintained offices in Taiwan for the purpose of buying tea, and the Standard-Vacuum Oil Company had a branch office in Taihoku (Taipei). The only non-Japanese industrial interest was Tokki Gomei Kaisha, a sulphur mine owned by a British national. Aside from these minor foreign direct investments, Taiwan also borrowed US\$ 22.8 million (45.7 million yen) from a New York banking syndicate in 1931 to help construct a power plant on Lake Jitsugetsutan (Sun Moon Lake). This is the only known non-Japanese foreign loan received by Taiwan before World War II (Ho, 1978: 83).

Table 3.2

Types of Companies Owned by Taiwanese and Japanese, 1929¹⁰

Company Type	Total Capital	Japan%	Taiwan%	Other%
Limited by shares	287,939	78.40%	19.81%	1.79%
Mixed partnership	16,567	67.97%	32.03%	-
Unlimited liability	7,941	23.59%	76.41%	-
Total	312,447	76.46%	21.89%	1.65%

3.6. Capital Inflow and Economic Development in Taiwan during the Colonial Period

Japanese colonial policy both encouraged and favoured investment by Japanese companies, which accounted for most of the island's industrial activity by the time of the Second World War (Lim, 1991: 63-64). Japanese investment

¹⁰ Source: Chang (1955: 96). Mixed partnership companies are those where some shareholders have limited liability, some do not.

between 1895 and 1945 was chiefly focused on rice and sugar processing for export to the Japanese market. As a direct result, export of rice and sugar to Japan increased markedly, with Taiwan's share of total Japanese sugar imports, for example, increasing from 8.7 percent in 1903 to 81 percent in 1935 (Ranis and Schive, 1985: 88). Like other colonising countries, the Japanese concentrated on the exploiting the natural resources of Taiwan¹¹ and had an "Agricultural Taiwan, Industrial Japan" blueprint. This trend was not an exclusive one: Ranis and Schive (1985: 88) have observed that, although the traditional colonial exchange of rice and sugar for textiles and fertiliser was the dominant transactional flow, food processing became an increasingly important activity.¹² However, there was little encouragement of domestic industry beyond the processing of agricultural goods for export and the construction and operation of utilities required to support those processing activities. Japanese FDI during the colonial period should be regarded as private, but was strongly encouraged by tariff protection and subsidies which, viewed as part of the colonial policy, provided substantial competitive advantages to Japanese investors over potential Taiwanese producers.

In the 1930s, Japan changed her colonial policies as she re-militarised. War preparations forced Japan to widen the island's industrial base beyond food processing (Huang, 1989: 98). In addition, Japan re-evaluated the strategic importance of Taiwan in geopolitical terms, leading to Japanese investments in heavy industries such as cement, chemicals, pulp and paper, fertilizer, petroleum refining, and metallurgy. Employment in these activities doubled between 1930 and 1939. Manufacturing output grew at 6.6 per cent annually during the thirties,

¹¹ Patterns of colonial investment and resource flow in most LDCs involve the colony supplying the colonising country with primary products; in return, the colonising country supplies the colony with manufactured consumer goods.

¹² By 1930, close to 20 per cent of Taiwan's national income was being generated within industry, with food processing accounting for 75 per cent of industrial output and 55 per cent of industrial employment. For detailed discussion, see Ho (1978) and Mizoguchi (1979).

although food processing remained the dominant activity within the total manufacturing sector (Ranis and Schive, 1985: 88).

PART TWO

LAW, FOREIGN DIRECT INVESTMENT AND ECONOMIC DEVELOPMENT IN TAIWAN, 1945-1983

The interaction between law and the economy in Taiwan will be examined in Part II, through discussion of the Government's economic policies at different development phases, especially in the context of FDI. Government policy has played a crucial role in shaping the pattern of economic development in Taiwan. During its economic development, Taiwan's Governments have adopted various strategies with a particular view to promoting industrialisation. These strategies were primarily dictated by circumstances, and their points of emphasis often varied as circumstances changed. Because its FDI policy is part of the Taiwan Government's macroeconomic policy, the FDI policy has been modified in each economic development phase and FDI law has been reformed accordingly. The purpose of Part II is to answer two questions: first, what were the Government's attitudes, strategies and policies regarding FDI in Taiwan, and how did these relate to development of the economy as a whole? Secondly, how did the Government, under differing economic circumstances, use legal incentives to attract and control FDI in order to fulfil its economic goal of industrialisation? Although a country's economic development is a continuous historical process, for the purposes of analysis I shall, in this Part, divide the economic development of Taiwan into four phases: post-war recovery (1945-1952), primary import-substitution phase (1953-1960), primary export-substitution phase (1961-1972), and secondary import and export substitution phase (1973-1983).

Chapter 4

Government Policy Regarding Economic Development and FDI during the Post-War Recovery, 1945-1952

After the Japanese withdrew from Taiwan, there was a hiatus without any FDI to speak of. Nonetheless, despite the initial absence of FDI it may fairly be said that the Government's policy of stabilising the post-war economy between 1945 and 1952 laid down the economic foundation for FDI in later development. The purpose of this chapter is to examine the political and economic conditions in Taiwan immediately after World War II, together with the KMT government's strategies for economic recovery after the conclusion of the civil war. It will be seen that two factors, in particular, made the painful post-war process of rehabilitation and reconstruction in Taiwan less difficult, and helped in laying down the basis for economic development later on. One was the success of land ownership reform; the other was American aid. The Government's programme of land reform is closely related to the *Min-Sheng* philosophy, which underpins the economic doctrines of the KMT. The programme's success was essential to the ability of the Taiwanese people to participate in, and receive the distributive benefits of, the Government's economic reforms. Early political and economic stabilisation also owed a lot to American aid. Aid programmes not only helped Taiwan with its economic needs, but also facilitated a psychological security. Finally in this chapter, the reasons for, and method of, the Government's adoption of an import substitution policy in this period will also be discussed.

4.1 Post-war Political and Economic Development in Taiwan: 1945-1949

In the Cairo Declaration of 1943, U.S. President Franklin D. Roosevelt, British Prime Minister Winston Churchill, and Chinese Paramount-General Chiang Kai-shek undertook to return to China those territories, including Taiwan, which had been seized from it by Japan.¹ The Potsdam Proclamation of July 26, 1945, reaffirmed this intent.² At the end of World War II,³ Taiwan reverted to Chinese rule and became a province of the Republic of China (McAleavy: 1968: 333). General Ch'en Yi, a former Fukien governor, was appointed by Paramount-General Chiang Kai-shek as the first governor of Taiwan in 1945 (Lumley, 1976: 54).

During the previous fifty years of Japanese colonisation, the colonial government oversaw a 'green revolution', promoted public health improvements that reduced the mortality rate by more than one-half, and built a modern infrastructure of finance, transport, and education that facilitated commercialisation and rapid export growth (Myres, 1973: 33-41; Ho, 1978: 25-40). In 1939, Taiwan's

¹ Under Article 2 of the Treaty of Shimonoseki (April 17, 1895), Taiwan had in 1895 been annexed by Japan in perpetuity (Parry, 1979, vol. 181: 217-224; MacMurray, 1921: 18; [1907] *A.J.I.L.*, 1962, vol. 1 *supp.* : 378- 383; GBFCO, vol. 87: 799; Hertslet and Parkes, 1908, vol. 1: 362-368). The Cairo Conference took place on November 22-26, 1943. The participants issued a declaration rejecting all desire for territorial expansion and affirming the intention of their countries to demand the unconditional surrender of Japan. They pledged that Japan would be deprived of all Pacific islands occupied since 1914; that all territory seized from China, such as Taiwan, the Pescadores, and Manchuria, would be restored; and that Korea would be granted independence (Gold, 1990: 49; Sainsbury, 1985: 321; U.S. Department of State, 1961: 448-449).

² The Potsdam Conference was held at Potsdam, Germany from July 17- August 2, 1945. The chief participants were U.S. President Harry S. Truman, British Prime Minister Winston S. Churchill (or Clement Attlee, who became Prime Minister during the conference), and Soviet Union Marshal Iosif Vissarionovich Stalin. The conference mainly discussed the substance and procedures of the peace settlements in Europe, and determined that peace treaties would be drawn up. In the Potsdam Proclamation of July 26, 1945, the Allies reconfirmed the status of Taiwan. (Butler and Pelly, 1984: 709-710; Klafkowski, 1963: 312). For more information about the Potsdam Conference, see U.S. Department of State (1960), Feis (1960) and Gormly (1990).

³ Taiwan was formally restored to China on October 25, 1945.

highly productive farms were exporting large amounts of sugar, rice, tea and bananas, mostly to Japan. The per capita value of Taiwan's external trade in that year was thirty-nine times that of China, and one and a half times that of Japan itself (Barclay, 1954: 33; Meisner, 1963: 95). Under Japanese rule the island had known little abject poverty, and the Gross National Product (GNP) had increased by 8 per cent per annum since 1930, placing living standards far higher than on the Chinese mainland - although Chinese living standards rose substantially before the Japanese entered the Second World War (Lumley, 1976: 55). Urbanisation and industrialisation, however, made little headway in what remained a largely agrarian society (Myres, 1990: 17-18).

At the start of the Second World War, Taiwan was the oldest and wealthiest Japanese colony (Hsieh, 1985: 28). After the war, Taiwan's economy was left in ruins by the Allies' bombing and by the general neglect of the Japanese colonial government during the war. Li and Yeh (1967: 31-32) reported that during the war about three-fourths of industrial productive capacity and two-thirds of power-generating capacity were destroyed. Agricultural production in 1945 and 1946 was below one-half the peak reached in the colonial period (BOT, 1951; Ho: 1978: 104). On the one hand, with respect to internal capital resources, war-related damage to industrial capacity and infrastructure had significantly reduced the island's capital stock. The repatriation of Japanese administrators, managers, technicians, and skilled labourers at the end of the war intensified post-war dislocation because their management methods and technology could not be replaced quickly (Ho, 1978: 103). On the other hand, from the point of view of external capital resources, after decades of intermittent warfare the mainland's economy was in disarray (Gold, 1990: 50). In order to isolate Taiwan economically from deteriorating conditions on the mainland, the government attempted to adjust the rate of exchange between the Taiwan currency (*t'ai-pi*) and the mainland

currency (*f'a-pi*), and to regulate the flow of funds from the mainland to Taiwan⁴ (Chou, 1963: 31-38). The government also banned unauthorised wage and price increases and instituted the compulsory purchase of gold, silver, and foreign exchange (Gold, 1990: 52). Despite those efforts, the Taipei wholesale price index⁵ still increased by 260 per cent in 1946, 360 per cent in 1947, 520 per cent in 1948, and 3500 per cent in 1949 (PBAS, 1960: 36). Accelerating inflation was extremely damaging to the confidence and morale of the people. The Nationalist government,⁶ unfortunately, paid relatively little attention and could not give any assistance to the new province as it was struggling against the Communists⁷ in mainland China between 1945 and 1949⁸ (McAleavy, 1968: 333-34; Ho, 1978: 103; Hsieh, 1985: 28-29).

In politics, initial mismanagement cost the Nationalist government much goodwill among the Taiwanese. It is said that initially the Taiwanese had eagerly welcomed the Nationalists and the Chinese army as liberators in 1945, and had looked forward to participating as full citizens of the ROC (Gold, 1990: 50; Lumley, 1976: 55-56). But Governor Ch'en Yi, who was appointed by the Nationalist government in Nanking, seems to have cared little for the Taiwanese. He introduced a harsh, authoritarian regime of social control, and in fact treated

⁴ In the meantime, to gain control of the economic situation, the KMT government on the mainland inaugurated a new currency, the gold yuan (*chin-yüan*), at the value of one gold yuan to three million old yuan (*f'a-pi*) (Gold, 1990: 52).

⁵ The Taipei wholesale price index is a simple geometric average of the wholesale prices of fifty domestically-produced and imported commodities (PBAS, 1960: 36).

⁶ The terms 'Nationalist', 'Kuomintang' and 'KMT' are used interchangeably in this thesis.

⁷ The Chinese Communist Party (CCP) was formally instituted in 1921 (Hu, 1951: 4- 7). In 1935, Mao Tse-tung emerged as party leader. In June 1945 he was formally confirmed as chairman of the CCP, and he held this post until his death in 1976 (Hsieh, 1985: 19).

⁸ The factor which caused the outbreak of the Chinese civil war in August 1945 was the Manchuria crisis; both the KMT government and the CCP tried to get the final control over Manchuria. The situation became more complicated when the Soviet Union also joined the race for Manchuria, motivated by its strategic and economic significance (Hsieh, 1985: 22- 25).

Taiwanese as second-class people.⁹ His discriminatory policy antagonised the native population and provoked tension between the latter and the 1.5 million mainlanders (military and civilian) who came to the island after World War II (Hsieh, 1985: 28-29). The nationalists from the mainland spoke standard Chinese (*kuo-yü*), the official language. By contrast, the Taiwanese in general spoke the Fukinese dialect (*fu-chou-hua*) of their ancestors and found standard Chinese unintelligible. The language and culture difference made the gaps between *pen-sheng-jen* (i.e. those who already lived in Taiwan before 1945) and *wai-sheng-jen* (those who came to Taiwan after 1945) ever wider. Soon the resentment exploded in violence. In the spring of 1947 there was an uprising, the so called '2-28 Incident', which the Nationalist garrison crushed with considerable severity.¹⁰ Figures for the total number of victims island-wide range from 10,000 to 20,000 (Kerr, 1965: 310). The '2-28 Incident' became an international scandal, and had a profound effect on the Taiwanese.¹¹ It was one of the events which alienated American sympathy from the Kuomintang (McAleavy, 1968: 334). Many Taiwanese (*pen-sheng-jen*) became apolitical following the '2-28 Incident', yet remain bitter towards the *wai-sheng-jen* even today.

During the next few years of civil war, living standards in Taiwan declined, runaway inflation consumed existing wealth, unemployment worsened, and an invasion from the mainland by the Chinese Communists seemed imminent (Myres,

⁹ The early activities of the Nationalist government in Taiwan during 1945-1949 have been extensively criticised by scholars, such as Kerr (1965), Gold (1990), Lumley (1976) and Hsieh (1985).

¹⁰ For details of the '2-28 Incident', see Mendel (1970), *Shen-keng tzu-liao-shih* (1983), Shih (1980), Department of State (1949: 309), Historical Research Commission of Taiwan Province (1967), Lumley (1976) and Gold (1990).

¹¹ One consequence was that a few of the Taiwanese who had been active in the uprising escaped to Hong Kong, United States, Japan and some European countries, where they advocated an independent state of Taiwan, governed by Taiwanese (*pen-sheng-jen*) only, and appealed to the memory of the uprising to stimulate Taiwanese antipathy toward KMT rule. Although a new Chinese Governor, Wei Tao-ming, was appointed in May 1947, he was unable to repair the damage caused by the uprising (Hsieh, 1985: 28-9).

1990: 18). As Ho (1978: 103) summarises it, Taiwan drifted aimlessly for several years following World War II. In 1949, however, when China's civil war came to an end and the Communists defeated Kuomintang forces and gained control of the mainland, the Nationalist government retreated to Taiwan (Tien, 1992: 3). Panikkar (1981: 107) has argued that if the Americans had been able to carry everything before them in Korea¹² they might have been tempted to encourage Chiang Kai-shek to attack the mainland and thus precipitate a major international war. Yet this was not the general perception of the Taiwanese, many of whom believed that the Communists would strike at any moment, and when that happened no help would be forthcoming from America. Indeed, U.S. President Harry S. Truman had declared, on 5 January 1950, that the U.S. government, "according to the Cairo Declaration, accepts the view that Taiwan belongs to China" and that "the United States will not pursue a course which will lead to involvement in the civil conflict in China. The United States will not provide military aid or advice to Chinese forces on Formosa" (US Government, 1959: 79; McAleavy, 1968: 334). In other words, the US government would not have prevented a Communist take-over of Taiwan had it happened.¹³ However, the sudden outbreak of the Korean War motivated the US to reshape its China policy (Cooper, 1995: 20). To prevent the

¹² The Korean War broke out on 25 June 1950 as North Korean forces launched an attack on South Korea. See Panikkar (1981: 102-116). Panikkar was in China as Ambassador of India to the National Government at Nanking, and later to the People's Republic of China (PRC) in Peking, between 1948 and 1952. Regarding U.S. and U.N. involvement in the Korean war, see e.g. Foot (1985), Kaufman (1986), Stairs (1974), Gardner (1972), Cotton and Neary (1989), Bowett (1982) and Higgins (1970).

¹³ Though it wanted to see a strong and united China, the U.S. was not especially concerned with who (Chiang Kai-shek or Mao Tse-tung) or which political party (the KMT or the CCP) would gain control of China. The U.S. believed that although the Chinese people were temporarily controlled by the CCP in the interests of Soviet imperialism, the Chinese people would ultimately "reassert themselves and throw off the foreign yoke" (Acheson, 1949; Gupta, 1969: 218-30). The U.S. 'wait and see' attitude towards the Communist government caused US-ROC relations to reach their lowest point at that period, between the moment of the release of the US White Paper on China on 5 August 1949 and the outbreak of the Korean War on 25 June 1950 (Clubb: 1974: 1365-1409). The US reshaped its China policy after the sudden outbreak of the Korean War (Congressional Quarterly, 1967: 48). Its new policy towards China, and the American aid to Taiwan will be dealt with in more detail in Chapter 4.2. For more information on US-ROC relations, see, e.g. Chung (1971), Barnds (1977), Graebner, (1977), Cohen, Friedman, Hinton and Whiting (1971), Bueler (1971) and Tsou (1963).

war from spreading further, on 27 June 1950 President Truman announced the decision to “neutralise” the Taiwan Strait by ordering the Seventh Fleet “to prevent any attack on Taiwan” (US Government, 1959: 2468; Chiu, 1979: 221). He also reversed the US view of the legal status of Taiwan: “The determination of the future status of Taiwan must await the restoration of security in the Pacific, a peace settlement with Japan, or consideration by the United Nations” (Ibid).¹⁴

1953 is the earliest year in which official information is available about FDI in Taiwan (TSDB, 1997). Official records do not disclose any evidence of FDI in Taiwan between 1945 and 1952. One of the reasons for this may be that the Nationalist government was fighting a civil war with the Communists during this period. Only after 1949, when the Nationalist government retreated to Taiwan, did the reconstruction of Taiwan begin in earnest. One can also assume that, because of the civil war, the whole of China (including Taiwan) was a very high risk area for foreign investors. There was probably no, or at least very little, foreign investment in Taiwan during the period. The further absence of official records regarding FDI between 1949 and 1952 is probably due to the fact that the KMT government was still very unstable during its first few years in Taiwan.

It may be useful at this juncture to mention a number of vital assets, facilitating order and progress in its economy, that Taiwan could count on. First, the colonial education system left Taiwan with one of the most literate populations in

¹⁴ Despite the fact that, under the terms of the Cairo declaration, Taiwan was returned to the ROC and after 1945 administered by the government of the ROC, several options had been suggested for the disposition of the island. For instance, in 1950, the US proposed that Taiwan could (a) continue as a province of and the seat of government of the ROC; (b) be placed under UN trusteeship; or (c) become an independent nation. The ambiguity of Taiwan’s legal status grew more complicated when the PRC’s Foreign Minister, Chou En-lai, filed a complaint against the ROC’s position on the island to the President of the Security Council and the UN Secretary-General on 24 August 1950. His complaint demanded the immediate expulsion of the ROC delegates from the United Nations and its associated bodies because they ‘illegally’ occupied these positions. For a full account of the development of the ‘China Issue’, see United Nations, General Assembly Official Records, 1949-1971, and United Nations Yearbook, same period. The dispute over the ‘China Issue’ has also been addressed by scholars internationally: see, e.g., Hsieh (1985); Chiu (1979); Larkin (1971).

Asia¹⁵ - a great advantage to any developing country.¹⁶ Secondly, notwithstanding wartime damage, Taiwan's infrastructure in 1945 was sufficient to rank the island as one of the most developed areas in China (Long, 1991: 77). Thirdly, many of the institutions created during the colonial period¹⁷ could be quickly revived. Fourthly, its agriculture was, after Japan's, the most advanced in the Far East (Ho, 1978: 104). Finally, owing to the stability it enjoyed during the colonial period, Taiwan at the time of World War II had an extremely well-ordered society. Indeed Taiwan in 1945 was probably a better-organised society with fewer signs of social disintegration than any of the other political units which were governed by the Nationalist government.

4.2 Post-war Recovery: The Government's Economic Policies, 1949-1952

Besides Taiwan's favourable inheritance, from the Japanese colonial period, there were several developments between 1949 and 1950 that had a tremendous influence on Taiwan's post-war recovery and economic development.

First, there were a large number of mainlanders who took refuge in Taiwan in the late 1940s¹⁸ when the Nationalist government's position, on the mainland, became clearly untenable. Among the refugees was a small group of talented

¹⁵ In 1952, the earliest year for which data are available, the literacy rate was 58 per cent in Taiwan (TSDB, 1997: 10).

¹⁶ The expressions 'developing country' and 'less-developed country' are used interchangeably in this thesis.

¹⁷ Such as agriculture experimental stations, credit co-operatives, the farmers' association, and various banking facilities.

¹⁸ From 1946 to 1950, more than 1 million mainland armed forces and civilians arrived in Taiwan (Ho, 1978: 105), living among 6 million Taiwanese (Hsieh, 1985: 29). Total population increased up to 8.4 million by 1953 (Hsieh and Lee, 1966; TSDB, 1997: 8).

officials, technicians, managers and entrepreneurs. Their arrival enabled Taiwan to partially fill the human resources gap created by the departure of the Japanese in 1946 (Ho, 1978: 104-105), and to minimise problems associated with replacing the Japanese presence (Fei, Ranis and Kuo, 1979: 26).

Secondly, certain military developments affected the psychological mood of the Taiwanese, leading to a more positive environment for economic regeneration. Initially, President Chiang Kai-shek and his followers thought Taiwan would be a temporary refuge, a military and political base for their recovery of the mainland. However, defeat shattered the morale of Chiang's followers, who still had to face the uncertain fate of a widely-expected Communist military assault (Tien, 1992: 3). Transformation was effected by the outbreak of the Korean War which (as was noted earlier) forced the Truman administration to alter American policy regarding Taiwan.¹⁹ On June 27 1950, President Truman ordered the Seventh Fleet to patrol the Taiwan Straits and to assist Taiwan in the event of any military action by the Chinese Communists.²⁰ This change of policy not only made the island militarily more secure and prevented the possible annihilation of the Nationalist forces by the Communists, but gave the Taiwan people a significant and much-needed psychological lift (Ho, 1978: 105; Tien, 1992: 3; Hsieh, 1985: 82-84). The military assistance from the U.S. saved Taiwan's inhabitants from the terror and destruction of war, and made post-war recovery and development less difficult.

Thirdly, the Nationalist Party (Kuomintang, or KMT) established an emergency regime in Taiwan.²¹ On May 10, 1948, as the civil war was nearing its

¹⁹ The US government was convinced of two things by the Korean War. First, of the aggressive nature of the Chinese Communists. Secondly, of the strategic importance of Taiwan to US security interests against the Soviet Union in the Pacific Ocean (Hsieh, 1985: 83-84).

²⁰ This instruction was enshrined in treaty form in late 1954 with the signing of the US-ROC Mutual Defence Treaty, which was essential to the security and stability required to attract investment (Klein, 1992: 257; Hartland-Thunberg, 1990: 114).

²¹ In December 1948, Chiang had sent a trusted General, Ch'en Ch'eng (1897-1965), to be Taiwan's new governor and had assigned his eldest son Chiang Ching-kuo (1906-1988) to head the

end, the ROC government on the mainland promulgated the Temporary Provisions Effective During the Period of Communist Rebellion (*tung-yüan-k'an-luan shih-ch'i lin-shih t'iao-k'uan*), commonly known as 'the temporary provisions'. These provisions, designated as supplements to the Constitution,²² were subsequently extended to Taiwan.²³ Further, in January 1950 President Chiang Kai-shek²⁴ issued an emergency decree that applied the 1934 martial law (*chieh-yen ling*) to Taiwan. The authorities justified these two emergency measures on the basis that China's civil war remained technically unfinished; Taiwan was to be treated as a combat area (Tien, 1992: 7).

The emergency measures suspended many important articles of the ROC Constitution (Hu, 1985: 8-19). The temporary provisions extended virtually unlimited power to the ROC's president at the expense of the constitutional authority of the Legislative Yüan and the Executive Yüan (the Cabinet).²⁵ The

provincial Party organisation. The head office of KMT (*tsung-ts'ai* office) was moved to Taipei in August 1949, and on December 9, 1949 the KMT government moved its temporary Capital from Chungking, Szechuan to Taipei, Taiwan (Gold, 1990: 53-54).

²² The Constitution of the ROC, originally drafted in 1936 and adopted by the National Assembly on December 25, 1946, promulgated by the National Government on January 1, 1947, and came into effect on 25 December, 1947. It was, and still is, the fundamental law of the ROC. It is also regarded as the mandate on which the Government's rule is based. The Constitution is modelled most closely upon that of Germany, with departures from that model which reflect the legal and political traditions of China, and the teachings of Dr. Sun - especially his philosophy of *Sun Min Chu I* (T'sui, 1959: Chapter 13-15).

²³ The temporary provisions were passed by the National Assembly on Taiwan on 18 April 1948 (Lin *et al*, 1991: 8-9).

²⁴ Chiang Kai-shek retired from the presidency in January 1949 after a disastrous defeat by the Communists at the Battle of Huai-hai. But from his position as *tsung-ts'ai* and supreme commander, Chiang continued to run the Government. He resumed the presidency in March 1950 (Gold, 1990: 53, 55).

²⁵ The ROC Constitution reaffirmed Dr. Sun Yat-sen's *San Min Chu I* (Three Principles of the People), which I will discuss in Chapter 4.2.1, as the basic philosophy of the state. It called for a division of power between five government bodies of Yüans: the executive (the Cabinet), the legislature (the law-enacting organ), the judiciary (the agency to interpret the Constitution and serve as a court of last resort), the control (the agency exercising the power of administrative impeachment and of supervising officials), and the body responsible for the civil service examination. It also enshrined the people's rights of initiative, referendum, election and recall. The fundamental national policies outlined in the Constitution comprise six sections: national defence, foreign affairs, national economy, social security, education and culture, and frontier

president not only served for an unlimited term but also had enormous power over the appointment of key government personnel. He was empowered to create extra-constitutional institutions, such as the National Security Council (*kuo-an-hui*) and the Garrison Command (*ching-pei-tsung-pu*), to perform emergency functions.²⁶ The martial law severely restricted the protection of individual rights and liberties guaranteed in the 1946 Constitution (Gold, 1990: 54). Under the martial law decree, the military acquired extraordinary power over matters normally of civilian concern (Tien, 1992: 7). During 1950-86, an estimated 10,000 civilian cases were tried by military courts (Tien, 1989: 111). Martial law was widely viewed as a symbol of political repression.²⁷ Yet, it is noteworthy that what the Government did was in keeping with an old Chinese proverb: '*luan-shih yung chung-tien*', which means the government should carry out severe punishment under strict laws during times of anarchy and disorder in order to maintain national security and social order. Certainly, the ingredients for disorder were present: as the mainlanders began to emigrate to Taiwan at the end of the 1940s a number of Communist secret agents, capitalising on local dissatisfaction with the Nationalist government of the ROC, started to infiltrate into the island. While it is beyond the scope of this thesis to assess whether such incursions upon basic liberties were justified, strict social control appears to have been regarded by the Government as necessary to maintain

regions (Article 137- 169 of the ROC Constitution; China Year Book, 1979: 635- 653). The Constitution may be amended directly by the National Assembly (the agency responsible for amending the Constitution and for electing the President and Vice President) or upon the proposal of the Legislative Yuan to the National Assembly (Article 174 of the ROC Constitution; *ibid*).

²⁶ In accordance with the procedure prescribed in para. 1 of Article 174 of the Constitution, the provisions empowered the President: "during the Period of Communist Rebellion, by resolution of the Executive Yuan Council, to take emergency measures to avert an imminent danger to the security of the State or of the people, or to cope with any serious financial or economic crisis, without being subject to the procedural restrictions prescribed in Article 39 or Article 43 of the Constitution" (China Year Book, 1979: 651- 52).

²⁷ On the institutionalisation and effects of martial law, see Kagan (1982: 48-54) and Peng (1971: 473-473).

a steady society, without which the recovery would have been more difficult and economic development delayed.²⁸

The fourth significant factor in post-war recovery was that the U.S. assisted Taiwan not only militarily, but also economically. U.S. aid permitted Taiwan to grow and to remain relatively stable while maintaining an unusually large military establishment. U.S. aid, as will be discussed in the next section (Chapter 4.2.2), was critically important to Taiwan's development.

With the sudden rapid increase in population and a change in the political situation between 1949 and 1950, the impact upon Taiwan's economy was enormous. In order to feed and clothe a much-enlarged population, it was necessary both for the process of industrialisation to begin, and for Taiwan to recover its pre-war levels of agricultural production (Huang, 1986: 108). In the meantime, the Japanese triangular pattern of resource use based on food exports, as practised in Taiwan between 1895 and 1945,²⁹ required modification, because of the loss of the protected Japanese market.

The Government adopted a balanced strategy of joint agricultural and industrial growth. Its approach was characterised by the government's own slogan: 'Developing agriculture by virtue of industry and fostering industry by virtue of agriculture' (Ho, 1978: 105; Hsing, 1971: 185). The Sino-American Joint Commission on Rural Reconstruction (JCRR) and the Productive Enterprises Control Commission in Taiwan District instituted a comprehensive programme to step up agricultural and industrial production (Hsing, 1971: 151-152). The first

²⁸ In October 1986, the KMT Central Standing Committee decided to suspend the martial law decree. This decision went into effect during the following year (July 14, 1987). Thenceforth, all civilian suspects would be tried in regular courts while the power of the Garrison Command was subject to new restrictions. It is believed that Taiwanese society has since become greatly liberalised (Tien, 1992: 13). The temporary provisions were suspended in May 1991 by the President Lee Teng-hui (see Chapter 8 below).

²⁹ See Chapter 3 above.

phase was land reform, by means of the 37.5 per cent Land-Rent Reduction Programme. As will be seen in Chapter 4.2.1(B), the successful implementation of an extensive rent-reduction and land-redistribution programme strengthened agriculture as a preliminary to industrialisation.

To shift its economic centre of gravity from agriculture to industry, Taiwan adopted policies that were to a large extent dictated by circumstances. In the early 1950s inflation kept the New Taiwan dollar³⁰ (NT\$ or *hsing t'ai-pi*) over-valued, and imports exceeded exports by growing margins. In order to prevent the hyper-inflation and a balance-of-payment crisis, and to restore the normal market mechanism, the government decided to introduce drastic monetary reform, and to impose a system of strict controls over imports and foreign exchange as supporting measures (Hsing, 1971: 151). This was one of the five phases of Taiwan's economic development - an early phase of import substitution. A strategy was developed to encourage the domestic production of consumer goods and of some intermediate goods that had previously been imported³¹ (Ho, 1978: 106-107).

After the Japanese surrendered in 1945, the KMT government confiscated former Japanese industrial assets and reorganised them into state enterprises. The decolonisation process in Taiwan, therefore, not only eliminated the foreign presence but provided the ruling regime with key economic as well as political resources, which proved to be crucial in implementing successful land reform in 1952 and in controlling the economy during the following years (Huang, 1989: 98). Because of the success of land reform, agricultural productivity increased. Agricultural and processed agricultural goods were the principal earners of foreign exchange in the 1950s, and helped to finance the initial capital and raw materials

³⁰ The New Taiwan dollar was first issued in June 1949 (Lin, 1973: 31-32).

³¹ By the mid-1950s, the early phase of import substitution had ended and the economy turned sluggish. The government was again forced to rethink and to modify its industrialisation strategy (Ho, 1978: 106). The manner in which it did so will be discussed further details in the next chapter. (Chapter 5)

imports required by the growing industrial sectors. By 1953, with the exception of export-oriented products, 'outputs of most products had surpassed their pre-war peaks by sizeable margins' (MEA, *Industry of Free China*, 1959: January; PBAS, 1946: 793-815; Chang and Shih, 1975: 291; Clough, 1978: 72). The real income per head in 1953 was only slightly below the 1935-36 average (Hsing, 1971: 152; Hsieh and Lee, 1966). These statistical data show that 1952 was a very important turning point between the end of post-war recovery and the beginning of true development. The changing times would soon receive signal acknowledgement, with the Government's decision to create the Industrial Development Commission (IDC) under the auspices of the Economic Stabilisation Board in July 1953, and embarked on the first Four-Year Economic Plan in the same year (Hsing, 1971: 152-3).

4.2.1 Economic Doctrine and Land Reform

Taiwan's economic strategy and gradual political liberalisation between the early 1950s and early 1990s appears to a significant extent to have flowed from the broad doctrines, embraced by the KMT of Dr. Sun Yat-sen's *San Min Chu I*, known to the West as the 'Three Principles of the People' (Nationalism, Democracy and People's Livelihood). In the political realm, Sun advocated the idea of tutelary democracy in which a vanguard party would gradually educate the people so that they could finally exercise full self-government. In the economic sphere, Sunist doctrine held that the state should play a leading role in promoting economic growth and change, controlling the business sector (especially foreign capital) to ensure its contribution to national development, and stimulating a rising standard of living and equitable distribution of income (D. Chang, 1989: 11-32; C. Chang, 1989; Gregor, Chang and Zimmerman, 1981; Metzger, 1987: 19-81; Myres, 1987: 1003-1022). This is not to say that *San Min Chu I* provided an operational guideline for Taiwan's policies. However, it certainly constituted a broad signpost and

legitimizing motif for the considerable economic and political reforms which the KMT implemented in Taiwan.

The main purpose of this section is to study the essence of the ROC's ideological roots, *Sun Min Chu I*; together with its relationship to the ROC's policy of economic development, and its significance in the formation of the government's strategy for land reform.

(A) Economic Doctrine and Policies - Three Principles of the People (San Min Chu I) and the Min-sheng Philosophy³²

As mentioned in the previous section (Chapter 4.2), Dr. Sun Yet-sen's³³ ideas have served as a reference-point for policymakers in the ROC (Gregor, Chang and Zimmerman, 1981: Chapter 1). Dr. Sun drew up theoretical schemes of government, combining Western and Chinese elements.³⁴ According to Dr. Sun, the

³² For details about Dr. Sun Yat-sen and The Three Principles of the People, which have been thoroughly discussed by scholars, see Sun (1928), d'Elia (1931), Wilbur (1976), Schiffrin (1957). I shall focus on the main elements of the *Min-sheng* principle in this thesis, as it is more directly relevant to economic development.

³³ Dr. Sun Yat-sen was born on November 12, 1866, and died on 12 March 1925 (Wilbur, 1976: vii; Gangulee, 1945: XXii). He was a man devoted to a single cause - the political reform of his country. Reform was his life's ambition (Wilbur, 1976: 9). Dr. Sun spent lifetime trying to reshape his country's political system according to his vision. He also drafted imaginative plans for China's economic development, plans which were impossible to achieve in his own day, but which presaged the schemes for international co-operation in assisting underdeveloped countries. He also had compassion for the poor and oppressed, though his ideas for changing their condition were essentially those of a reformist rather than of a social revolutionary (Wilbur, 1976: 8). He was one of the founders of the Nationalist Party (Kuomintang or KMT). He brought an end to the Ch'ing (Manchu) dynasty in the Autumn of 1911, and established the Chinese Republic (Wilbur, 1976: 18-19). He was later canonised as *Kuo Fu*, the Father of the Country. To the Chinese he has become a symbol of the virtuous patriot (Wilbur, 1976: vii). He is now the only modern hero shared by the Mainland and Taiwan. Their common celebrations of Sun's memory, insists Schiffrin (1980: 27), 'could prove a useful psychological bridge if they are ever to be reunited peacefully'. For bibliographical sketches of Dr. Sun and his political philosophy, see Tan (1972: 116- 223), Boorman (1970: 170- 189) and Chong (1967).

³⁴ Although born in the Kwan-tung, Dr. Sun spent much of his childhood in Hawaii, where he was educated at a college founded by Church of England missionaries. He seems to have been much influenced by Christian teaching and Western ideas there. Sun had also learned Chinese classical history during his childhood (Hsieh, 1985: 73).

formation of the *San Min Chu I* ideology was inspired by Abraham Lincoln's famous phrase, "Government of the people, by the people and for the people" (KMT Central Committee, 1976: 29). He planned an audacious economic transformation for China, aiming to achieve a better life for all classes, while preventing the abuses of capitalism and the inter-class conflicts he observed abroad. He believed in the power of education and sought to encourage the dissemination of ideas and political thought (Wilbur, 1976: 286).

In one of his speeches on January 4, 1922 in Kwei-lin, Dr Sun described France and the United States as old-fashioned republics. "The Chinese", he said, "should build a new type of republic". "To build a new country requires putting into effect his Three Principles of the People (*San Min Chu I*)". These, according to Dr. Sun, were first, *Min-tsu* (the Principle of Nationalism),³⁵ meaning equality among the races,³⁶ with none dominating over others; secondly, *Min-ch'uan* (the Principle of Democracy), meaning equality among the people of a nation, with no minority oppressing the majority and everyone enjoying his natural rights; and thirdly, *Min-sheng* (the Principle of People's Livelihood), referring to economic equality in terms of absence of exploitation of the poor by the rich (KFCC, 3: 233-35; Wilbur, 1976: 120). In other words, the Three Principles of the People mean government 'of the people, by the people, and for the people' - that is, a state belonging to all the people, a government controlled by all the people, with rights and benefits for the enjoyment of everyone.³⁷ If this is achieved, the people will not

³⁵ Nationalism (or *min-tsu*) means literally 'people's race', and has been more generally held to mean 'national solidarity' (Hsieh, 1985: 59).

³⁶ There were five major ethnic groups in China: the Hans, the Mongols, the Manchus, the Moslems and the Tibetans. The Hans regarded themselves as the authentic Chinese. Thus, both Mongol rule in China during the fourteenth and fifteenth centuries and the Manchu dynasty from 1664 until 1911 were considered to be alien. Dr. Sun was not against the 'alien' rule of the Manchus. What he actually opposed was their inability to govern China. In view of their inflexible opposition to any institutional or social reform, Sun was convinced that China needed to undergo a total transformation with the abolition of the monarchic system.

³⁷ According to Dr. Sun, this ideology is identical to the French Revolutionary slogan: 'Liberty, Equality and Fraternity' (Shih, 1961: 13).

only have a share in state production, but they will have a share in everything. When citizens share everything in the state, the society truly reaches the goal of the *Min-sheng* principle, which is Confucius' highest political aspiration of the ideal world of *ta-t'ung*, or *t'ien-hsia wei-kung*, meaning the 'Great Commonwealth'³⁸ (Gangulee, 1945: 91; Hsieh, 1985: 59).

Dr. Sun argued that the social and economic structures of China must be readjusted in order to provide the above conditions, without which political institutions cannot function in the interests of the masses. He particularly stressed what he called the Principle of Livelihood, because it concerns the life of the nation. Neither nationalism nor democracy can survive unless citizens are assured of reasonable material welfare. The principle involves two radical measures: the equalisation of land, and the control of capital. These are regarded as necessary for the protection of the interests of the peasantry and the working class (Gangulee, 1945: xxxiii), and for the ultimate aim of the *Min-sheng* principle, of equalising the financial resources in society (Gangulee, 1945: 90). He emphasised the importance of avoiding the social inequities arising from unregulated capitalism, and attempted to specify how this might be achieved - by establishing state enterprises in the area of railways, utilities, and other large-scale industries,³⁹ and through a rather vaguely defined taxation theory derived from John Steward Mill and the American Henry George, involving the taxation of future rises in land value. Although termed

³⁸ Unfortunately, Dr. Sun's manuscript on "The Three Principles of The People" perished in flames when his headquarters were destroyed in 1922, but its main thesis was made available to his followers in a series of lectures he delivered spread over a period from January 24th to August 1924 of that year (Schiffrin, 1980: 253). From the stenographic notes of these lectures *San Min Chu I* was published after his death. In this book the Republic of China found not only a call for the rebirth of the nation, but also a programme of action (Gangulee, 1945: XV). For a detailed study of the Three Principles, see Price (1927). Price translated *San Min Chu I* into English. His translation was later abridged and edited by the History Commission of the KMT for the compilation of the KMT history. Most of Sun's writings and his speeches are to be found in Sun (1956).

³⁹ This approach might explain why the KMT government insisted upon retaining control over critical industrial production and services like energy and water in the early 1950s (Myres, 1990: 43).

‘equalisation of land rights’, he viewed the scheme as “essentially urban rather than agrarian, and preventative rather than remedial” (Schiffrin, 1957: 549-64; Chiang, 1974: 147-99). It did not envisage the general nationalisation of land for redistribution purpose, but instead was directed toward restricting the unearned profits made by private owners whose land, as often happens during the modernisation of cities, had vastly increased in value by reason of its situation and the development of industries and communications through the labour of the community. By these techniques, Dr. Sun hoped that the main evils of capitalism would be avoided⁴⁰ (McAleavy, 1968: 176-77). He also held that, since China was traditionally an agrarian society, it was essential to tackle the problems caused by unequal distribution of land ownership. To this end, he proposed the ‘Land to the Tiller’ programme, intending that the man who worked the land would also own it and thereby be assured of having the means of providing for himself and his family.

Dr. Sun’s favoured scheme, for equalisation of property, was to be achieved by two means - (1) taxation based on the owner’s declared valuation of land, accompanied by a right on the part of the government to purchase it at that value, and (2) government appropriation of unearned investment which is due to general socio-economic improvement. He believed this was much fairer than the nationalisation of property practised in Europe and America, which amounted simply to confiscation (KFCC, 1: 211; Schiffrin, 1957: 549-64; Wilbur, 1976: 245). He still saw the ideal solution in terms of Henry George’s method. ‘Equalisation of land rights’ was effectively a taxation device to prevent future speculation in land, particularly in cities, and to give the government the option of buying back land from large owners (Schiffrin, 1980: 256).

⁴⁰ The ‘equalisation of land rights’ was a scheme based on Henry George’s thesis that the private appropriation of increases in land values was the cause of modern social inequities (Hsieh, 1985: 62). Dr. Sun maintained that his doctrine was a special branch of socialism suitable to Chinese conditions: a programme by which China could, in the course of its modernisation, avoid the social evils and injustices that had attended the industrialisation of the capitalist nations of the West (Boorman, 1970: 187).

The economic doctrines of the Kuomintang government may be said in many ways to reflect the Three Principles of Livelihood, containing as they do the two fundamental aspects of equalisation of land and regulation of capital. Since the ownership of land at that time was confined to only a few, the state should enact laws for the utilisation, expropriation, and taxation of land. Under such laws, private landowners were required to declare the value of their land to the government. It would be taxed according to the value so declared and the government was empowered to buy it at that price in case of necessity (Gangulee, 1945: 96); for example, in order to build new roads. Private industries, whether belonging to Chinese or foreign nationals, which are either monopolistic in character or beyond the capacity of private individuals to develop - such as power, railways, and shipbuilding - were to be undertaken by the state, so that privately-owned capital should not control the economic life of the people (Gangulee, 1945: 96-7). Thus, in accordance with Dr. Sun's policies the state should have *some* control over the state's essential industries. At the same time, everyone would in principle be guaranteed sufficient food, clothing and other necessities, as well as the right to develop their own enterprises. Dr. Sun advocated regulation of capital and state ownership of large-scale industry. He proposed borrowing development capital from abroad. He also expected to use "foreign brains and experience" to manage new industries. The goal was to "use existing foreign capital to build up a future Communist society in China"⁴¹ (Schiffrin, 1980: 257).

The KMT government's economic ideology was, and remains today, to promote economic development within a mixed economy which includes key features of socialism as well as capitalism. It advocates a more balanced ownership of land, a more equitable distribution of wealth and income, state enterprises in

⁴¹ Communism in this context owed more to Confucius' vision of the 'great commonwealth' than to Marxism-Leninism. Though he claimed that his doctrine of the People's Livelihood was both socialism and communism, Dr. Sun averred that Marxism, while meriting study as a form of Western socialism, was not only impracticable in China but also demonstrably erroneous in its thesis of surplus value and the class struggle (Boorman, 1970: 187).

certain industries, and state control of private industries. But it also believes in private property, profit incentive, and competition (Ho, 1978: 117). In brief, one general precept, that there must be planning within the context of a free economy, is a channelling principle through which many specific policy recommendations flow (Wo, 1981: 134). The government must not only take action to encourage the private sector's development, but should also allow free markets to function and permit the existence of private property. Myres has (1990: 45) suggested that such a mixture of concerns required the achievement of the following four objectives:

- (i) Most resources should be privately owned and managed except for those resources and activities that government deems necessary to manage on behalf of society, such as electricity, communications, national defence and social services.
- (ii) Policies should produce sustained, high economic growth rates but under conditions of social and economic stability.
- (iii) New wealth should not be created at the expense of others, and all groups should be able to share the flow of benefits from development.
- (iv) Economic growth should not be associated with distortions that lead to scarcities of resources or goods and services.

In order to achieve these objectives, various policies needed to be initiated, refined, and abandoned as conditions dictated. In the course of the chapters below (Chapter 5-8), I will examine the Government economic policies in different development phases and to consider how those policies were initiated, refined, and abandoned as circumstances changed, with particular reference to Dr. Sun's *Min-Sheng* philosophy and the use of foreign capital to help Taiwan's economic development.

(B) Land Reform

Probably the most important initial policy for restructuring incentives was the land reform that was carried out between 1949 and 1953. This extensive programme, involving changes in land distribution, conditions of tenancy, and rent, was effected in three stages: compulsory rent reduction, the sale of public land to actual tillers and the compulsory sale of private land to actual tillers (Koo, 1968: Chapter 3).

Hsü (1975: 769-773) ascribed the collapse of the KMT regime on the mainland to five factors:

1. Deceptive military strength
2. Inflation and economic collapse
3. Loss of public confidence and respect
4. Failure of American mediation and aid
5. Retardation of social and economic reforms

It seems likely that the second, the third and the fifth factors were in part affected by KMT's failure to instigate a proper land reform in the mainland areas they controlled. This perception is reflected in Long's (1991: 77-79) criticism that the KMT on the mainland represented the interests of the landlord-gentry class, which prevented the KMT from putting into effect Dr. Sun's 'Land to the Tiller' ideology. There was little doubt that the communists' success in winning popular support in China, whose population was overwhelmingly dominated by landless peasants, was in large measure due to their concerted efforts to redistribute land.

The KMT was anxious not to make the same mistake on Taiwan. Learning from its disastrous experience on the Chinese Mainland, it sought to use land reform to blunt the appeal of Communism among the peasantry as well as eliminate the Taiwanese landlord class as a competing elite (Thompson, 1984: 558). With the

emergence of small farmers as the dominant class, the KMT, in Hsiao's words (1988b: 8), "turned the rural sector from a potential source of political unrest into a fundamentally conservative social base".

In April 1949, soon after the Nationalist government moved to Taiwan, a programme to reduce rent was initiated. With the benefit of records collected by the Japanese, the programme was completed within three months⁴² (Lin, 1973: 31-32; Gold, 1990: 52). It was subsequently supplemented and reinforced by the 1951 Farm Rent Reduction to 37.5 Per Cent Act,⁴³ which made the relationship between tenants and landlords explicit. Farm rents were fixed at a maximum 37.5 per cent of the total annual yield of the main crops.⁴⁴ There were also provisions for the temporary reduction of rent in times of crop failure, for written contracts, and for the establishment of procedures to settle disputes between tenant and landlord (RGLPFLTP Articles 8, 9, 12, 13 and 15).

⁴² Cadastral surveys done by the Japanese during the colonial period provided the data necessary to implement land reform (Clough, 1978: 73).

⁴³ Passed by the Legislative Yuan on May 25, 1951.

⁴⁴ Cheung (1967: 90-98) and Tang (1961: 33-44; 221) have argued that rental restriction in Taiwan was not a fixed but a percentage restriction, i.e., the rent share was reduced to 37.5 per cent of the actual yield and not of a standard yield. Their interpretation may be due to the ambiguous wording of the 1949 Regulation Governing the Lease of Private Farm Land in Taiwan Province (RGLPFLTP). The relevant part of Article 2 of the Regulations reads as follows:

"Farm rent shall not exceed 37.5 per cent of the total annual yield of the main crops. If the rent originally agreed upon is greater than 37.5 per cent, it shall be reduced to 37.5 per cent; and if it is less than 37.5 per cent, it shall remain unchanged.

The 'main crops' referred to in the preceding paragraph shall be chiefly the crop customarily accepted as payment for rent. The *standard* amount of the total annual yield of the main crop shall be appraised with reference to relevant data in the light of actual local conditions by the Hsien or Municipal 37.5% Rent Campaign Committee [done in May 1949] and the results of the appraisal shall be submitted to the Provincial Government for approval."

While the first part of Article 2 seems to suggest that actual yield was to be used in determining rent, the last part of Article 2 makes it quite explicit that a standard yield was to be used.

In 1951, the government began the second stage of reform, the transfer of land ownership to actual tillers, when it began to sell public land to tenants (Tang, 1961: chap 3 and pp. 215-20; Clough, 1978: 73). More than fifty per cent of the farmland owned by the central and provincial government was eventually affected by this policy.⁴⁵ Cultivators of public land, and other tenant farmers, were given first and second priority respectively to purchase public land. The price of the public land was set at 2.5 times the annual yield of principal crops⁴⁶ and was to be paid in twenty instalments over a period of ten years. By 1958, about 71,000 hectares of this land had been sold and distributed (Ho, 1978: 161).

The most dramatic part of Taiwan's land reform was the land-to-the-tiller programme. That a farmer should own the land he tills is a political objective of the Nationalist government (see Chapter 4.2.1(4) above). The 1953 Land-to-the-Tiller Act (LA) and the Regulations Governing the Implementation of the Land-to-the-Tiller Act in Taiwan were the legal bases for the programme.⁴⁷ They codified the redistribution of privately-held farmlands (Long, 1991: 78).

Under the code, land was graded for quality and classified by owner. There were 26 grades for paddy land and 26 grades for dry land (Ho, 1978: 161). The LA limited landholdings to roughly three *chia*⁴⁸ (2.9 hectares) of medium quality (7th-12th grade) of paddy land or its equivalent, while the government compulsorily purchased all land held in excess of that size for redistribution to other rural

⁴⁵ Most of the land retained by the government was land operated by the government-owned Taiwan Sugar Corporation (Ho, 1978: 161).

⁴⁶ The yield used to determine land price was not the actual yield, but the standard yield assigned by the local government to that grade of land for tax purposes. In most instances the standard yield was lower than the actual yield (Ho, 1978: 161).

⁴⁷ The Land-to-the-Tiller Act was passed by the Legislative Yüan on January 20, 1953. The Regulations Governing the Implementation of the Land-to-the-Tiller Act were promulgated by the Taiwan Provincial Government on April 23, 1953.

⁴⁸ 1 *chia* = 0.9699 hectares = 2.4 acres.

households⁴⁹ (Koo, 1968: Chapter 3; Clough, 1978: 73; LA Articles 8, 10 and 11). Perhaps the most successful feature of the reform was the method of landlord compensation adopted by the government. The price paid for the land was 2.5 times its annual yield. Landowners were paid 70 per cent of the purchase price in Commodity Bonds; i.e. ten-year bearer government bonds, redeemable in either rice or sweet potato, depending on whether the land was paddy-field or dry (Long, 1991: 78). The Bonds paid a 4 per cent annual interest.⁵⁰ The balance of 30 per cent was paid in shares of stock in four government enterprises⁵¹ shortly to be transferred to the private sector⁵² (Clough, 1978: 73).

The land was then sold to its former tenant farmers at the same price at which it had been purchased. The new farming class received government loans to purchase their land (Myres, 1990: 46). They paid for the land in ten annual instalments and a 4 per cent annual interest in rice (for paddy land) and in sweet potatoes, converted to cash (for dry land) (Clough, 1978: 73; Ho, 1978: 162-3). The credit matched the terms of the government's own 'land bonds in kind' (Commodity Bonds) (Long, 1991: 78-79).

The compulsory purchase of farmland and its re-sale to tenants began in May 1953 and was completed in December of the same year. In total, nearly

⁴⁹ However, if the landlord cultivated as well as leased his land, he was permitted to retain the land he cultivated (i.e., operated with no more than the normal seasonal hired help) even if in excess of the retention limit (LA Articles 8, 10, 11).

⁵⁰ The principal and interest were to be amortised in 20 equal semi-annual instalments (Ho, 1978: 162).

⁵¹ Yang (1970: Chapter 4) reports that 98 per cent of 500 surveyed former average-landlords and 91 per cent of 75 surveyed former large-landlords sold their stocks soon after receiving them. In the long term, this behaviour was to weaken the landowners' economic position.

⁵² The four enterprises, all confiscated from the Japanese, were the Taiwan Cement Corporation, Taiwan Pulp and Paper Corporation, Taiwan Industrial and Mining Corporation, and the Taiwan Agricultural and Forestry Development Corporation. In 1954 the government began to transfer these firms to private ownership amidst a flurry of stock price manipulation (Gold, 1990: 71).

144,000 hectares of land changed hands (Tang, 1961: 289, 292-93; Chen, 1961: 311). Between 1949 and 1953, the percentage of land under owner-cultivation grew from 51 to 79 per cent, while tenant-farmed land dropped from 42 to 21 per cent (PDAF, Taiwan Agricultural Yearbook, 1954).

Taiwan's land reform brought about two basic changes in agriculture: (1) a sizeable number of share-croppers became owner-cultivators, and (2) a ceiling was placed on rent (Ho, 1978: 164). One important effect of these changes was the elimination of share-cropping.⁵³ More than any other reform it encouraged increased agricultural productivity, since new owner-operators had strong incentives to increase their incomes by working longer hours, increasing multiple cropping, and adopting technological innovations (Clough, 1978: 73). Stimulated by the reforms, agricultural production rose 43 per cent from 1952 to 1960. Rice yields increased by 25 per cent per hectare in that period (Long, 1991: 79; Long, 1989; TSDB, 1997: 66-67).

Apart from giving tenants and small farmers the opportunity to purchase property of their own, the land reforms also had the effect of directing rural landlords into urban businesses. Both groups had considerable incentive to use their financial and physical resources efficiently because of the new opportunities now available to them. Land reform greatly improved the distribution of income, and helped to promote better management of the land and to raise productivity (Myres, 1990: 46). Tang (1961: 149) has estimated that as much as 13 per cent of Taiwan's 1952 Gross Domestic Product (GDP) was redistributed. The reform also enabled the government to control and to keep down the price of rice over the next decade. In addition, it was a useful stimulus to domestic investment, as the government began to divest itself of its commanding role in the industrial economy (Long, 1991: 78). The government was efficient in exploiting the agricultural surplus to

⁵³ Many have argued that sharecropping leads to an inefficient combination of resources (Johnson, 1950; Sen, 1966: 445-46; Adams and Rask, 1968: 935-37; Georgescu-Roegen, 1960: 23-26).

finance its early industrialisation. Low rice prices set by the government meant that land taxes, paid in kind, were in effect high. The farmers were forced to sell part of the rice harvest via the so-called 'rice-fertiliser barter'.⁵⁴ The government, through the Farmers' Associations, acquired rice and provided fertiliser at a fixed ratio between the two products. In this system of unequal exchange the government, which monopolised fertiliser through delivering it to the farmer in exchange for cheap rice, made a large profit from the transaction (Bello and Rosenfeld, 1990: 184). Wang and Apthorpe's (1974: 11, 148) criticism, that the government took a substantial chunk of the farmer's remaining production, thus seems a valid one. The farmers needed to pay a land tax, a water fee, and other taxes, though the amount was less than the rent to the landlord had been before land reform. Yet this controversial system provided the government with ample supplies of rice⁵⁵ to take care of the armed forces, the civilian government employees, and their dependents, as well as a surplus to dispose of on the open market as a means of influencing prices (Huang, 1986: 108; Clough, 1978: 74-75). Its control of such a huge segment of the rice harvest practically eliminated the free market in rice, since, whenever the price went too high, the Provincial Food Bureau would release its stock onto the market until the price moved back to the level desired by the government (Hsing, 1971: 175). The government's dominance of the rice market was important in enabling the ROC to hold the average annual price increase between 1953 and 1974 to 7.5 per cent, a better record than that of many developing countries (TSDB, 1993: 167; TSDB, 1966: 161, 299). At a macroeconomic level, this meant that resources were transferred more rapidly from the countryside to the cities (Long, 1991: 80).

⁵⁴ The rice-fertiliser barter scheme was abolished in 1972.

⁵⁵ In upshot, the government gained control of 40 per cent of the marketable supply (Hsing, 1971: 175).

Land reform has the potential to be a powerful influence in the economic life of any country. Taiwan's land reform is often cited as a model for developing countries, and has attracted much interest in recent years from, for example, the Philippines (Long, 1991: 79). It is worth mentioning three points which were crucial to its success: (1) The land survey carried out during the Japanese period provided an important data base with which to administer the land reform. (2) Landowners received compensation for their land. Because they were in principle hedged against inflation, the payment in bonds and stocks made the compulsory purchase of land more palatable to landlords. (3) The KMT government arrived in Taiwan as an 'outsider', with no tie or commitments to the indigenous Taiwan gentry. Because they lacked such ties, the landowners, who preferred not to sell their lands, had no political means with which to resist the reforms. Taiwan therefore enjoyed greater political flexibility regarding land reform than do most developing countries, since the Government did not depend on the landlord class for support (Ho, 1978: 162; Long, 1991: 77-8).

Because of the success of land reform in the early 1950s, the former tenant farmers now owned the land they tilled; consequently agricultural productivity increased - an important boost for Taiwan's suddenly-enlarged population. At the same time, the interest of former landlords was diverted from agriculture to industry in the wake of the reforms. This new demographic group was to be an essential component in Taiwan's industrial development.

4.2.2 American Aid - A Driving Force of Taiwan's Early Economic Development

In the 1950s, following its commitment to the KMT after the outbreak of the Korean War, the United States became an influential agent in Taiwan's economy. Except for a limited quantity of surplus agricultural commodities, no U.S. economic aid has been committed to Taiwan since June 30, 1965 (Ho, 1978:

111). From 1951 to 1967, the U.S. provided Taiwan with a total of US\$ 4.1 billion in aid, playing a decisive role in Taiwan's economic development in general, and in its industrial development in particular (U.S., House Foreign Affairs Committee, 1967: 63). The legal framework for the U.S. aid was provided by the Sino-American Mutual Security Treaty, under which the General Economic Aid (GEA) originally consisted of Defence Support, Technical Co-operation and Direct Force Support (Hsing, 1971: 191; Hsieh, 1985: 86). The objective of the aid was originally to stabilise Taiwan's economy, and later to help develop Taiwan's economic development. Between 1949 and 1967, Taiwan received US\$ 425 (or US\$ 187 if military assistance is excluded) per capita (Ho, 1978: 111). In 1960, Taiwan's per capita income was only US\$ 143 (TSDB, 1997: 34). Since the mid-1950s, an increasing proportion of U.S. economic aid to Taiwan has been in the form of loans rather than of grants, while military assistance has been nearly exclusively in the form of grants.⁵⁶ The amounts of both economic and military aid declined steadily in the 1960s (Ho, 1978: 111). In 1962, aid came under the administration of the Agency for International Development (AID), formally established in 1961; grants previously provided under 'Defence Support', and loans under the 'Development Loan Fund', were unified under the heading of 'Development Loan', while the category of 'Technical Co-operation' grants were redesignated as 'Development Grant' (Hsing, 1971: 191). In addition to these categories of aid, the U.S. also provided surplus agricultural commodities. This form of aid, made available under U.S. Public Law 480 (Pub. L 480) from 1955 onwards, was administered by the U.S. Department of Agriculture (Lin, 1967: 295-318; Long, 1991: 80). It accounted for 25 per cent of U.S. aid obligations (Gold, 1990: 69).

⁵⁶ Most heavy equipment, planes, ships, and vehicles were supplied by the US as a grant. The Development Loan Fund (DLF) was established in 1957, to offer financial assistance to those development projects that were considered technically and economically feasible, but which were not eligible for assistance under GEA (Hsing, 1971: 191).

During the period 1951-65, raw materials accounted for the greatest portion of aid deliveries by far (TSDB, 1997: 234). However, if we break down the project aid by sector, it is noticeable that the allocation to electricity and transportation increased steadily (TSDB, 1997: 230). As a nation of free enterprise relying on private initiative, the U.S. was not an enthusiastic supplier of direct aid to agriculture and to individual mining and manufacturing industries.⁵⁷ However, the U.S. aid authority rightly identified the development of electricity, transportation, and other infrastructure facilities as a key to economic development. As Jacoby (1966: 179-180) pointed out, inadequacy of infrastructure facilities was a serious bottle-neck to development, and this accounts for the drastic change in percentage allocation of project aid in favour of electricity and transportation between 1961 and 1965 (Hsing, 1971: 193-194).

Foreign aid increased the resources available to Taiwan, and helped to lessen the conflict between Taiwan's economic and military objectives. Taiwan, since 1949, has had to support, on a per capita basis, one of the world's largest armies.⁵⁸ The government has justified this unusually large military presence on the grounds that it is engaged in a 'civil war' and that a large army is needed not only to protect Taiwan from communist attacks but also to fulfil its foremost political goal: eventual reoccupation of (or more recently, reunification with) the Chinese mainland. In the 1950s, and in most of the 1960s, Taiwan's military establishment consistently absorbed about 12 per cent of its GNP, or about 80 to 90 per cent of the central government's expenditure (Hsieh, 1985: 119; Lumley, 1976: 86). Of countries surveyed by the United Nations, only South Vietnam and Jordan were in the same category as Taiwan, and both were involved in active wars (UN:

⁵⁷ The U.S. did attach great importance to the rehabilitation of agriculture's in the early 1950s. Once this was achieved, however, its concern shifted to the modernisation of industry and the industrial infrastructure. (Hsing, 1971: 193).

⁵⁸ Although the KMT government has never officially disclosed the size of its army, independent estimates have consistently placed Taiwan's military strength in the 1950s and 1960s at around 550,000-600,000 (*London Institute for Strategic Studies*).

Yearbook of National Accounts; IBRD, 1968: world table 6). From 1951 to 1967 the United States gave US\$ 2.4 billion, out of the US\$ 4.1 billion total U.S. aid, in military assistance 'necessary to carry out mutual US-ROC obligations' (Long, 1991: 80). The economic aid from the U.S. enabled the KMT government to defend Taiwan without undue strain on the economy.⁵⁹

In Taiwan, foreign aid contributed to economic development in several related ways:⁶⁰ it helped to control inflation, relaxed a binding foreign exchange constraint, and permitted a high level of capital formation (Ho, 1978: 111). These effects will now be considered.

(A) Stabilisation

U.S. aid, in the early 1950s, played a critically important stabilising role and helped the rather battered Taiwanese economy to recover after World War II. As was mentioned earlier, Taiwan's inflation in the early 1950s was very high. In order to help industries recover from the war, the government expanded bank credit and doubled the money supply (Ho, 1978: 112). As a consequence prices soared. To increase public confidence in the newly-introduced New Taiwan dollars (NT\$), the

⁵⁹ The tension between the Chinese mainland and Taiwan continued even though the U.S. 7th Fleet patrolled the Taiwan Strait. The first Quemoy crisis broke out in September 1954 and dragged on for nine months, caused mainly by an attack by the Chinese Communists on Quemoy and Matsu. The Communists were said to have fired 17,243 rounds of shells at Quemoy, and indeed continued its bombardment even after the crisis. The second Quemoy crisis broke on 23 August 1958. During the second crisis, Chinese Communists fired about half a million shells in 44 days; in all 571,959 rounds of explosive shells during 1958. The heavy bombardment was said to be an attempt to blockade Quemoy's re-supply line from Taiwan. For more information concerning the two crises, and relations between the two Chinese rivals and the United States during the period, see Gurtov (1976: 49-103), Tsou (1959), Lewis (1962: 13-19), George and Smoke (1974: 266-389), and Clubb (1959: 517-531).

⁶⁰ It is inconceivable that, in an economy devastated by war and with ensuing large trade deficits, any significant progress could have been made without foreign aid. This is not only true for Taiwan but also true for post-war Western Europe and Japan. Lumley (1976: 84- 85) calculated that if the U.S. did not restore economic aid in 1950, the actual GNP of Taiwan in 1964 would not have been reached until 1980, and the per capita GNP would not have been produced until 1995. The relationship of foreign aid to economic development has been studied extensively in the literature. See, for example, Chenery and Bruno (1962: 79-103), Chenery and Strout (1966: 679-732), Ranis (1973) and Bhagwati and Eckaus (1970).

government directed the Bank of Taiwan to redeem short-term time deposits in gold; which caused a large net outflow of non-monetary gold (valued at US\$ 50.8 million in 1950) from Taiwan⁶¹ (Wang, 1994: 112). Additionally, the government's attempt to absorb excessive liquidity in the economy by offering realistic interest rates to bank depositors proved to be a reasonably effective anti-inflationary policy (Irvine and Emery: 1966, 29-39). In the spring of 1950, the Bank of Taiwan had begun to raise interest rates on its deposits. By attracting floating funds and thus limiting spending, it broke the back of post-war inflation (Myres, 1990: 33). With rates of 9 per cent a month, time deposits in the banking system increased dramatically, rising from NT\$ 2.3 million in March 1950 to NT\$ 33.3 million in June 1950 (BOT, TFSM, 1954: 17; Wang, 1994: 113). Bank deposits continued to grow during the next three years, while simultaneously the rate of price increases greatly declined. Such a solution could only operate in the short term, however, because of the unwanted side-effect that credit costs were too high to undertake new investment and expansion. The government subsequently moved to lower its loan rates, although it continued to charge higher interest rates for businesses and individuals than for public enterprises (Myres, 1990: 33).

However, the main reason why inflation was kept within controllable limits was the resumption of U.S. aid in the latter part of the 1950s (Ho, 1978: 113). The severe inflation of the late 1940s - prices rose by 3400 per cent in 1949 alone - was reined in to 9 per cent by 1953 with the help of foreign aid inflows (Ranis and Schive, 1985: 90). U.S. economic aid provided Taiwan with large amounts of chemical fertiliser, wheat, and cotton, the daily necessities and raw materials needed to stabilise and rehabilitate the economy. Although inflation was high in 1955-56 and again in 1959-60, in both cases the causes of instability were poor

⁶¹ This wasteful use of government gold, at a time when Taiwan was in desperate need of foreign exchange, was halted in December 1950 (Wang, 1994: 112).

weather⁶² and increased military expenditures⁶³ (Ho, 1978: 114). Indeed, without U.S. aid, price increases during these two periods could easily have gone out of control.

(B) Foreign Exchange Relief

Chenery (1962: 79-103; 1966: 679-732) has argued that foreign aid is primarily a gap filler. Specifically, it can be used to remedy a deficiency in either reserves or foreign exchange (Ho, 1978: 114). In the context of Taiwan, an obvious deficiency was the lack of foreign exchange. By filling the foreign exchange gap, U.S. aid relieved this constraint on the economy, and permitted a higher rate of economic growth and a fuller utilisation of other productive inputs in the economy (Jacoby, 1966: 124; Ho, 1965: 63- 142; Liang, 1970: 36- 44; Liang and Lee, 1972: 27- 35). During 1951-1955, over 40 per cent of Taiwan's imports were aid-financed (Ho, 1978: 115).

The contribution of foreign aid to investment in Taiwan was also substantial (McKinnon, 1964: 388- 409). In the 1950s, nearly 40 per cent of gross domestic capital formation was financed by foreign savings; almost all of that came in the form of U.S. aid (DGBAS, 1970: 136- 151). The availability of foreign aid not only increased foreign savings, but also made possible the fuller utilisation of domestic savings (McKinnon, 1964: 388-409). Taiwan's domestic production and U.S. aid "formed a fungible pool of resources" that was used to support private and government consumption and investment (Ho, 1978: 116).

⁶² Because Taiwan in the 1950s was primarily agrarian, its economic health depended, to an unusual extent, on the weather. Since the government lacked an adequate reserve of either food or foreign exchange, it was unable to stabilise the market for any extended period of time. Thus any weather condition that adversely affected agricultural production had far-reaching economic effects and inevitably caused prices to rise.

⁶³ Taiwan's defence spending increased sharply during these periods due to communist forces attacking Quemoy.

(C) Capital Formulation

Because it was a government-to-government programme, U.S. economic aid had considerable impact upon the Government's economic policies, and on how these policies were implemented. In the 1950s, because of large military costs, the Government's domestic revenues were not sufficient to cover its total expenditures, with the deficits financed mainly by U.S. aid (Jacoby, 1966: table C. 12).

One suspects that the KMT government would have preferred the public sector to spearhead Taiwan's economic development because that would have strengthened its control of the island.⁶⁴ However, for several reasons a different approach was followed. In the 1950s and for much of the 1960s the government's economic projects were limited primarily to those financed by U.S. aid. On the other hand, AID was strongly committed to the growth of the private sector, and used its influence and resources to improve the climate for private investment (Jacoby, 1966: 138; Hsing, 1971: 199-120). The private sector would not have become Taiwan's mainspring source of economic growth without AID's influence and active intervention (Jacoby, 1966: 138). AID helped to create a more conducive environment for the expansion of private industries, by (1) financing government projects, (2) inducing the government to liberalise its economic policies, and (3) laying a constraining hand on military expenditures (Ho, 1978: 117). In terms of direct assistance, however, AID provided little to the private sector. The preponderance of economic aid was given to the public sector⁶⁵ (mainly to infrastructure and human resources). U.S. aid to the public enterprises was used to

⁶⁴ The economic ideology of the KMT government includes features of socialism and capitalism. It advocates a more balanced ownership of land, state enterprises in certain industries, and state control of private industries. It also believes in private property, profit incentive, and competition. When the KMT governed the mainland, it established public enterprises in competition with the private sector on numerous occasions. This behaviour suggests that the KMT government was not strongly predisposed to develop the private sector (Ho, 1978: 117).

⁶⁵ From 1951 to 1965, 67 per cent of all aid was allocated to public enterprises or agencies, 27 per cent to mixed public and private enterprises, and only 6 per cent to purely private enterprises (Jacoby: 1966, 51).

increase the productivity of private industrial investments, and helped to ensure the expansion of the private sector (Jacoby, 1966: 52).

On a number of occasions AID offered to increase the level of aid if certain government actions were taken and threatened to reduce it if the government failed to act⁶⁶ (Jacoby, 1966: 134-35). In particular, AID brought intense pressure to bear upon the KMT government to hold down its military spending. Its efforts to influence the Government were not always successful: the KMT government adhered to its preference for the military and continued to enlarge its military budget, although at a less rapid rate (Ho, 1978: 118).

AID was more successful in persuading the KMT government to develop economic policies that were developmental rather than control-oriented. During the late 1940s and the early 1950s, the Government had imposed a large number of temporary regulations and controls. These included a multiple-exchange rate system, import and foreign exchange controls, hidden subsidies, and rationing and administrative pricing of certain goods and services, in addition to various bureaucratic obstacles to private business (Ho, 1978: 119). Because these controls created distortions and inefficiencies in the economy, their presence reduced the productivity of investment and thus inhibited economic development. AID, in 1958, argued for a relaxation of economic controls and an improvement in the climate for private investment. The government eased the regulations on foreign investment and overseas Chinese investment, and simplified the multiple-exchange rate system in 1959 (Ho, 1978: 119). In the subsequent four years (1960-63), the KMT government introduced other important reforms: among others, a statute for the encouragement of investment, the conversion of the multiple exchange rate system to a single rate, the relaxation of trade and exchange controls, and the simplification of business laws and regulations. The combined effect of these actions permitted

⁶⁶ The most notable example of this was AID's attempt in 1959-60 to induce the KMT government to adopt the 19-Point Programme of Economic and Financial Reform (see Chapter 6).

the economy to pursue an outward-looking growth strategy, one that has been given much of the credit for Taiwan's growth in the 1960s and the early 1970s. Economic aid from the US ended in 1965, stimulating the KMT government to intensify its efforts at economic development (Liu, 1985: 161): trade and exchange controls were further relaxed, the government became more receptive to Japanese investments, industrial sites and export-processing zones were created, and positive measures to promote exports were adopted (Ho, 1978: 119-120).

From the moment it retreated to Taiwan in 1949, the Nationalist government pursued three major objectives - rapid economic growth, stable prices, and a strong military presence. Without foreign aid to remedy the deficiencies constraining the economy, it is unlikely that these conflicting objectives could have been achieved. There is no doubt that U.S. aid had an immense impact on Taiwan, albeit not always beneficially. Politically, it made possible the survival of the KMT government in Taiwan. Economically and socially, it helped to restore stability and facilitated the development of a viable private sector and a growing middle class.

4.2.3 Government Economic Policies and FDI during the Early Import Substitution Phase, 1949-1952

Economic stability was the Government's primary concern in 1949. In May of that year it established the Taiwan Production Board (TPB), with the primary aim of stabilising the economy through promoting various initiatives. It was chaired by the provincial governor. With the addition of an Industrial and Financial Committee in early 1950, its activities expanded beyond co-ordinating production, supply, and trade (Gold, 1990: 68). In 1953 the TPB was absorbed into the Economic Stabilisation Board (ESB), established in 1951 on American advice. The ESB's function was to review and co-ordinate trade, payments, and monetary and fiscal policies, in order to control inflation, with a subcommittee making specific decisions about Taiwan's import requirements and the part to be financed by U.S.

aid (Hsing, 1971: 184). The ESB included an Industrial Development Commission (IDC) which was responsible for overseeing the formation and implementation of economic plans adopted by the Government from 1953 onwards. The ESB was chaired by the governor and later by the premier. By moving the chief economic agency from provincial to national level, the ESB increased its power and merged the identity of the central government with the island (Gold, 1990: 68).

During the 1950s many newly independent countries, most of which were less-developed, were created from former colonial states.⁶⁷ Almost all of these new countries were plagued with population pressures, general food shortages, government budget deficits, foreign exchange shortages, and inflationary pressures. It followed that economic development became their first priority (San, 1991: 32; Hsieh, 1992: 16). One popular development strategy among these agriculture-oriented countries was the implementation of an import substitution policy. The justification was two-fold. First, the terms of trade for importation of agricultural goods from less-developed countries (LDCs) to industrial countries had deteriorated over the past century. The LDC should therefore not rely on the export of agricultural goods to develop its economy, but should develop its own industries, and the 'infant industry' in its own country should be protected accordingly (Hou, 1987). Secondly, in light of the great depression which occurred in the U.S. in the 1930s, and of the Government response during that decade, as well as the promotion of a welfare state policy in the U.K. after World War II, many believed that public enterprises could, and should, play a significant role in stabilising the economy through job creation (San, 1991: 32-33). Clearly, there was a complementary match between the promotion of public enterprises and the implementation of import substitution, which soon led to the flowering of 'public infant industries' in many of the LDCs in Asia and Latin America.

⁶⁷ e.g. Nigeria, Uganda, North Vietnam, Ghana, Kenya.

For the KMT government, the island's loss of its traditional export market in Japan and mainland China, together with high levels of inflation and chronic balance-of-payments deficits, dictated an import-substituting economic course (Huang, 1989: 98-99). Therefore, in the 1950s Taiwan followed an inward-looking development strategy based on import substitution in manufacturing.⁶⁸

Many public-related enterprises established by the Japanese were controlled by the ROC government after 1945. At that time, the principal endorsed by Dr. Sun, "enhance the nation's capital and constrain the accumulation of private capital", was a central doctrine of government policy. Within the government, however, there was a division between those who favoured continued state dominance of the economy, based on its ownership of dozens of confiscated Japanese enterprises in several sectors,⁶⁹ and those who advocated a greater range of activity for the private sector. Both sides could claim legitimacy in terms of Dr. Sun's vague instructions on the restriction or regulation of capital (*chieh-chih tzu-pen*) (Chiang, 1947: Chapter 4; Ts'ui, 1959: Chapter 22). Sun had written that the state should own enterprises in key sectors related to national defence, natural monopolies, or where capital requirements were so great that private entrepreneurs could not afford the risk (Gold, 1990: 67). Everything else could be left to private capital. Alighting on compromise, the KMT government did not hasten to privatise government-owned public enterprises, but encouraged the development of an otherwise weak private sector in Taiwan (San, 1991: 33). This balance changed over the decade: in the early 1950s, the more state-centred cadres received greater support; in the latter part of the decade, coinciding with U.S. pressure, free enterprise came to the fore (Gold, 1990: 68).

⁶⁸ Top priorities were (cotton) textile and fertiliser industries, since textiles and fertilisers were two major imports at that time (Hsing, 1971: 188).

⁶⁹ These enterprises included sugar, aluminium, fertiliser, alkali, shipbuilding, brickmaking, machinery, power, cement, paper, mining, printing, hemp, textiles, tea, food processing, banking, and finance. See Shih (1980: 711).

To promote import substitution, various measures were introduced by the government in order to protect the development of domestic enterprises and to conserve foreign exchange reserves (San, 1991: 33). Among those measures, the most important were tariffs protection, import controls, and multiple exchange rate controls.⁷⁰

(A) Tariffs Protection

The tariff schedule enacted in 1948 was revised in 1955, 1959, and 1965 (Hsing, 1971: 210). In the 1948 schedule, over 60 per cent of items listed incurred tariffs of above 30 per cent (Tao, 1969: 174-75). Between 1948 and 1955, the average nominal tariff for all imports rose from 20 per cent to nearly 45 per cent⁷¹ (Tao: 1969: 175-78). In general, tariff rates for consumer goods⁷² were higher than for other goods (Hsing, 1971: 212). Estimates of effective tariff rates, the more appropriate measure of protection,⁷³ indicate that they were indeed substantially higher even than the nominal rates, and that protection was greater for non-durable consumer goods than for either intermediate⁷⁴ or capital goods (Liu, 1970: 379-466;

⁷⁰ Exchange and trade regulations are regularly reviewed in the IMF's: Annual Report of Exchange Restrictions. The U.S. Department of Commerce has also published periodic surveys of Taiwan's exchange and trade controls. See e.g., World Trade Information Service and Overseas Business Report. A useful survey of Taiwan's exchange and trade regulations is in Chang (1965: Chapter 7).

⁷¹ The revision in 1955 largely represented a belated adjustment to the withdrawal of ROC from General Agreement on Tariffs and trade (GATT) in 1950, and also reflected the desire of the Government to raise revenue to tide over financial difficulties in the early 1950s. For discussion of Taiwan's withdrawal from GATT, see Chapter 5.1 below.

⁷² Consumer goods are products used directly to satisfy human needs or desires, as opposed to capital goods, used to produce some other products or services. Consumer goods are generally classified into two major categories according to the degree of durability: (1) durables, such as passenger cars and appliances; (2) non-durables, such as food and clothing (Greenwald, 1983: 71-72; Ammer and Ammer, 1984: 98-99; Pearce, 1992: 78).

⁷³ Effective rate of protection is defined by Pearce (1992: 123) as "the increment in value added, made possible by the tariff structure, as a proportion of the free trade value added".

⁷⁴ An intermediate good is a good which is used at some point in the production process of other goods, rather than final consumption; for example, steel and wood. For a detailed definition, see Ruggles and Ruggles (1956).

Hsing, 1971: 238-66; Sun, 1966; Lee and Liang, 1971: 69-96). This discrimination clearly evidences the Government's intention to encourage consumption of domestically-produced end products.

(B) Import Controls

The Government used a system of import quotas to control foreign trade. After 1951 imports were classified into four categories: (a) permissible, (b) controlled, (c) suspended, and (d) prohibited.⁷⁵ Of the approximately 500 groups of commodities classified during the early 1950s, 55 per cent were in the permissible category, 40 per cent in the suspended and controlled categories, and 5 per cent in the prohibited category (Ho, 1978: 191). The matter was complicated by the fact that commodity quotas had *first to be classified within the categories above, and by the requirement that applications for imports had to be screened and approved on a case by case basis* (Hsing, 1971: 205).

Hsia (1954: 24-27) has compared domestic prices and import costs of selected raw materials in 1953, concluding that domestic prices were higher than import costs inclusive of tariffs by substantial margins in all cases. This indicates that during the early 1950s direct licensing under quotas was an effective constraint on imports.

(C) Multiple Exchange Rate Controls

Formally, there was only one official fixed exchange rate to settle external transactions, known as the basic rate of exchange, which was revised upwards at intervals; but for a long time it was applicable only to public exports and imports, and to a limited range of private exports. For the bulk of private exports, and all

⁷⁵ The permissible category included essential capital equipment, raw materials, and essential consumer goods, all of which were importable within the prescribed quotas (Hsing, 1971: 205). Items in the controlled category were to be granted import licences only if comparable goods were not produced domestically (Long, 1991: 82).

private imports, 'exchange certificates' were issued to effect exchange settlements between the Bank of Taiwan and both exporters and importers, with the price fixed in terms of local currency - generally called the 'exchange certificate rate' - at a rate higher than the basic exchange rate (Hsing, 1971: 206). In addition, there were certain other discriminatory exchange rates. For example, the complex multiple exchange rate system applied different exchange rates to different types of imports (San, 1991: 33). Under this system, a hidden tax was utilised in the exchange rates in order to discourage the importation of luxury or consumer goods and to subsidise the importation of basic raw materials and industrial products (San, 1991: 33). These exchange and trade controls promoted import substitution by effectively sealing off many of Taiwan's consumer goods markets from foreign competition, and by conserving foreign exchange for capital and raw material imports (Hsia, 1954: 24-27; Lin, 1973: 51).

While this system achieved the aim of encouraging import substitution, one should observe that it had many detrimental effects. The interests of private exporters were damaged by the Government's exchange control approach. This was not only because 20 per cent of their export proceeds had to be sold at the lower basic official exchange rate, but also because even the exchange certificate rate was much lower than the prevailing black market rate. Only private importers of raw materials and industrial goods were able to profit from the exchange rationing. At first, this opportunity was limited. Only licensed import merchants were entitled to foreign exchange for private imports, and quotas were allotted according to their respective past business records. But the system quickly became inefficient. Many former import merchants, though no longer in business, continued to receive exchange quotas, and sold their 'exchange certificates' to whoever offered the highest price. Importers continued to make unearned incomes at the expense of exporters. The effect of the multiple exchange rate mechanisms was to create new

vested interests, and to protect existing inefficient industrial enterprises (Hsing, 1971: 207).

In essence, during the 1950s the government kept the NT\$ over-valued, and maintained a multiple exchange system that applied lower rates to exports than to imports; and within imports, rather lower rates to capital equipment and raw materials (when purchased by end users) than to other goods (IMF, *Annual Report on Exchange Restrictions*). The over-valued NT\$ also proved to be detrimental to efficient economic growth and aggravated the balance-of-payment problem (Ho, 1978: 194). It may have increased the level to imports; because an undervalued foreign exchange encouraged local industrialists not only to import capital equipment but also to develop industries that were dependent on imports for raw materials. The major difficult and the most damaging effect of the over-valued NT\$ was that it penalised exports and discouraged development of export-competing industries. Once the early phase of import substitution was completed, it became increasingly difficult to maintain a rapid rate of industrialisation.

Owing to the small size of the domestic market, import substitution, once begun, was achieved quickly in those industries where a mastery of the required technology was relatively simple (Ho, 1978: 189). From 1949 to 1952, manufacturing production increased at an average rate of 22 per cent a year (Ho, 1978: 187). Lin, (1973: 68), drawing on Chenery (1960: 639-41) and Lewis (1969: 20-21), has estimated that over 91 per cent of the increase in non-food manufacturing production from 1937 to 1952 can be attributed to import substitution. Therefore, during the early phase of import substitution, although Taiwan was still a 'dual economy',⁷⁶ the Government's approach appears to have been effective. Its strategy of import-substituting industrialisation during the 1950s

⁷⁶ Rutherford (1992: 130) defines a 'dual economy' as a national economy with both a rich modern sector and a poor traditional sector. Originally this term was used to describe many colonial economies, such as Indonesia, Zambia and India, after the Second World War. For details, see Boeke (1953), Simonies and Simonies (1971) and Averitt (1968).

allowed existing and new firms to develop strong domestic positions free from import competition. A group of Taiwanese and mainland industrialists began to achieve success in some light industries, especially textiles (Huang, 1989: 99).

Most US investors in the late 1940s were not interested in immediate investment in post-war Asia because the possibilities for profit in the domestic market loomed so large (Schurmann, 1973: 115). Rather, they wanted unrestricted access to Asian markets only as a guarantee of future expansion in that direction. Even in the late 1940s and 1950s businessmen did not see Taiwan as a significant market or source of cheap labour, but rather as a symbol of an overall commitment to Pacific expansionism⁷⁷ (Barrett, 1988: 134).

During this post-war period, Taiwan desperately needed raw materials for its post-war recovery. Government FDI policy in this period was to welcome investment in food, clothes, chemistry and cement (Wu, 1993: 7). However, the nature of Taiwan's economic and political condition inhibited the arrival of FDI. Economically, the market was too small; the economy was unstable; the industry was backward; strict import, export, and foreign exchange controls meant that profit could not be guaranteed; and because of protectionism, there were no specific FDI incentives for investors. Politically, the future of Taiwan was uncertain. The KMT government had just lost a civil war and Taiwan was still under the serious threat of war. As mentioned in Chapter 4.1, political stabilisation was one of the important considerations for investors at that time. Taiwan had virtually nothing to offer foreign investors (Gold, 1990: 126). Therefore, it is not surprising that there was very little FDI in Taiwan during this post-war recovery period. The few investments Taiwan had at this period were from overseas Chinese (Wu, 1993: 6). The motives behind these investments went beyond the purely economic. Those who invested in

⁷⁷ The specific reasons why American investors were not attracted to Taiwan until the late 1960s have been explored in Barret and Whyte (1982: 1046-89) and Schreiber (1970).

Taiwan in this period thereby signified support for the Nationalist government (Gold, 1988a: 197).

4.3 Conclusion

As I explained in Chapter 4.2.2(A), U.S. aid not only helped Taiwan to survive during this difficult period, but also acted as a stimulus by helping to promote and support private sector involvement. More importantly, the AID mission also helped to pry open the Taiwanese economy to private foreign participation. Between 1951 and 1965, U.S. aid accounted for about 34 per cent of total gross investment in the Taiwan economy (Jacoby, 1966: 38). The nature of Taiwan's economy and its political-military situation in this period had inhibited the arrival of FDI in Taiwan. Indeed, most of the FDI coming into Taiwan during that time was from overseas Chinese. Only after U.S. aid had helped to stabilise the economy did these flows begin to increase appreciably (Simon, 1990: 149).

To summarise, between 1949 and 1952, the Nationalist government made full use of U.S. economic aid to reverse its economic and social disadvantages. It sold considerable property to private enterprise and initiated a programme of agrarian land reform. In order to encourage the investment in both public and private sectors, interest rates were maintained by the monetary authorities at artificially low levels (Yeh, 1994: 46). As a result, by 1952-53, production and distribution reached pre-war levels. By the end of this phase there was both optimism and concern over the economic future of Taiwan (Myres, 1990: 18). On the one hand, agricultural output had increased and the small manufacturing and services sectors had greatly expanded their productive capacity. On the other hand, the Nationalist government still relied extensively upon U.S. economic aid, which provided the country with much-needed raw materials for agricultural and industrial

production. In addition, the government allocated almost half of its budget to support the large military establishment.

Yet, on the whole, the optimism seemed justified, largely because the policy of import substitution had so far been successful. Import substitution called for strict controls to over-value the NT\$, to ration foreign exchange to preferred importers, and to regulate all foreign trade under quotas and tariffs. It protected infant domestic industries from foreign competition. However, much remained to be achieved. Though Taiwan's economic growth indicators in the early 1950s were impressive, there were no tangible signs that economic dualism had begun to disappear. Despite the Government's efforts to begin the first phase of industrialisation, agriculture still contributed a larger share to GNP than did manufacturing, generating the highest value of exports, and employing at least half of the labour force. The pace of urban growth remained very weak, while the population continued to increase at the rate of 3.5 per cent per year (TSDB, 1997: 8).

Chapter 5

Law, Policy and FDI during the Primary Import-Substitution Phase, 1953-1960

The beginning of a country's efforts to make the transition from colonialism to developed status is customarily assigned to the year of its political independence. For a number of reasons, however, 1953 is more appropriately regarded as the starting-point for Taiwan's transition than 1945 (when Taiwan became independent of Japan) or 1949 (when Taiwan became politically separated from mainland China). First, an economic system that was independent of the mainland economy did not begin to emerge until late 1949. Secondly, the Taiwanese economy did not recover from the bomb damage sustained during War World II until about 1951.¹ Real income per head only reached pre-war peak levels (of 1935 and 1936) in 1953.² Thirdly, 1953 was the year in which the Government promulgated its first Four-Year Economic Plan.³

According to the Government's official position, Taiwan's economic policy is to let market forces take their course. That is a highly over-simplified and exaggerated statement. Taiwan's Government has long had and still has a high degree of economic control (Scitovsky, 1990: 135). This reflects the *Min-sheng*

¹ By 1951, agricultural and industrial output had reached 1937 levels (Sun and Lee, 1985: 59).

² For detailed information, see Japan Economic Federation (1939) and Tax Division of the Governor's Office of Taiwan (1955).

³ Although 1953 is taken as marking the end of post-war recovery and the beginning of positive development in later years, there were important elements which helped Taiwan's economic development and which were already in place before 1953. For example, the influx of talented officials, managers, and entrepreneurs from the mainland in the late 1940s minimised problems associated with replacing the Japanese colonial presence (Fei, Ranis and Kuo, 1979: 26). Taiwan also possessed an unusually good physical and institutional infrastructure by 1953. It had a solid base of human resources to go along with the more common features of a surplus of labour on limited arable land.

philosophy behind Taiwan's economic policies - there must be planning within the context of a free economy. Economic planning in Taiwan followed almost immediately upon the arrival of the US economic aid mission. The Four-Year Economic Plans, started in 1953, were used to fully utilise US aid and to implement the Government's growth policies. There were six Four-Year Economic Plans, i.e. 1953-56, 1957-60, 1961-64, 1965-68, 1969-1972, and 1973-1976 (Hsing, 1971: 154). Li (1976: 93) and Lumley (1976: 89) have criticised the ESB's First Plan as "a rather crude effort" encompassing only agricultural and industrial reconstruction. The Government soon realised that the utilisation of aid funds should be linked to a programme of economic development (Lumley, 1976: 102-103). The Second Plan added separate communications projects together with special projects such as the Shih-men Reservoir, tidal land reclamation, vocational assistance for retired servicemen, and public housing. It specified measures for achieving the targets set, something the First Plan had not done (Li, 1976: 93). The essence of the plan was a linking together of applications for AID money (Gold, 1990: 70). It is not surprising that the first two plans, under ESB, were largely lists of desired projects that might be funded by aid donors with only scant reference to the rest of the economy (Woronff, 1992: 67).

During this stage, the Government decided to adopt the primary import-substitution pattern which is almost invariably identified with early post-independence policies of developing countries. During the primary import-substitution period, domestic industrialisation was the focus of attention (Ranis and Schive, 1985: 89-90). The creation of a domestic industry, and the accompanying appearance of a new indigenous industrial entrepreneurial class, was supported by a programme of direct protection and subsidies; introduced with the aim of diverting consumption away from imported to domestically-produced items. Import-substitution was made imperative by the loss of Taiwan's traditional markets following the war and its consequent independence from Japan, as well as the

disruption occasioned by evacuation and separation from the mainland (Lim, 1991: 64). It was characterised by the diversion of traditional export proceeds away from further expansion of the colonial economic triangle established by the Japanese, and towards investment which was intended to replace previously imported industrial consumer goods with domestically-produced consumer goods (Fei, Ranis and Kuo, 1979: 26-27). Liang and Liang (1976) have shown that this primary import-substitution period, whether defined in horizontal or vertical terms,⁴ came to an end by the late 1950s or early 1960s.

To promote economic development, the Government adopted a policy of 'cultivating industry through agriculture, and developing agriculture through industry' (Yeh, 1994: 50). In the area of agricultural development, land reform was continued and a 'Land-to-the-Tiller' programme was instituted in 1953 (see Chapter 4 above). At the same time, assistance was provided to the farmers for enhancing farming techniques and increasing agricultural production so as to improve the supply of foodstuffs and provide raw materials for processed agricultural products (Yeh, 1994: 51). Exports to earn foreign exchange were thereby strengthened and in turn financed imports of the equipment and raw materials needed to develop industry. In industry, due to the shortage of foreign exchange and technical manpower, the Government selected manufacturing industries with relatively low technology levels, relatively small capital requirements, and high labour-intensiveness as its main focus for support and development - industries such as textiles, glass, cement, wood products, paper, flour, edible oil, plastic, bicycles, and sewing machines - in order to generate substitutes for imported products (Sun and Lee, 1985: 59-60). To effectively foster the development of these industries, the Government adopted protectionist

⁴ Ratios of imports of nondurable consumer goods to total imports, and to total supply, both went up around 1960 (Liang and Liang, 1976).

measures such as import tariffs, import controls, multi-tiered foreign exchange rates, and restrictions on foreign exchange.

5.1 Protectionist Measures

The average nominal import tariffs rate almost doubled between 1948 and 1955, as a result of ROC's withdrawal from GATT.⁵ While the Government also hoped to augment its revenue by increasing tariff rates (Tao, 1969: 109), its main aim was protectionism. This may be seen from the fact that import controls became even tighter in the mid-1950s, as many commodities were switched from the 'permissible' to the 'suspended' and 'controlled' categories (TSDB, 1997).

By prohibiting the importation of luxury goods and controlling the imports of other consumer goods, the Government hoped to conserve foreign exchange for capital and raw material imports. In this respect the exchange and trade controls were largely successful.⁶ Industrial production and investment were encouraged by another aspect of the system. The multiple exchange rate system (see Chapter 4 above) applied an appreciably lower rate to imported capital equipment and raw

⁵ ROC was one of the original Contracting Parties to GATT, which it signed in 1948 (Brown, 1950: 75-157; Jackson, 1969: 650; Wilcox, 1972: 42; MOEA, 1987: 9). However, after the Nationalist Party moved to Taiwan and the Communist Party took over the mainland China, the treaty became inappropriate for a number of reasons. The Chinese Communist government refused to carry out the GATT obligations promised by the ROC government. In addition, the negotiated tariff concessions would apply to all exports, and thus the beneficiary would primarily be the mainland. Taiwan hardly benefited from the concession as Taiwan's exports were very little (due to the Government's policy of import substitution rather than export expansion at that time) (Hsiao, 1989: 39; Chou, 1968: 655; *China Times*, June 20, 1988; Hartland-Thunberg, 1990: 112). To avoid Communist China taking advantage of GATT membership, the ROC, after consulting with Department of State of the United States, notified the General-Secretary of the United Nations on 6 March, 1950 that the ROC would withdraw from GATT (GATT document GATT/CP/54, 8 March, 1950). In accordance with Article 5 of the 'Protocol of Provisional Application of the GATT', this withdrawal became effective on 5 May, 1950 (GATT-Status of Legal Instruments, Geneva, November 1986). For more information about the relationship between GATT and Taiwan, see Ho (1992, chapter 3).

⁶ During 1952-60 capital goods imports accounted for 23 per cent of total imports, agricultural and industrial raw material imports 67 per cent, and consumer goods imports only 10 per cent (TSDB, 1997: 193).

materials than to other transactions, and over-valued the NT\$⁷ (Shih, 1994: 91). Although Taiwan's import substitution policy encouraged industrialisation, it did not solve the balance of payments problem. The reason for this was that although import substitution altered the import structure by decreasing imports of consumer goods and stimulating imports of intermediate and capital goods, it did not reduce the total demand for imports (DGBAS, 1970: 156-157). Consequently, a large deficit on goods and services, amounting to almost 40 per cent of total imports, persisted through the 1950s (IMF, Balance of Payments Yearbook). The deficit was financed primarily by U.S. aid (Ho, 1978: 194).

As I discussed in Chapter 4, the system that existed from 1949 to 1958 set a favourable exchange rate for importing goods essential for economic development, applied a general exchange rate to bulk exports of the Government and highly profitable private exports, and applied a still more favourable exchange rate to other exports. This control system was both "supply restrictive" for exporters and "cost restrictive" for importers, so that the fixed multiple exchange rate favoured different parties, particularly the Government (Myres, 1990: 46). The system worked reasonably well in the early 1950s to reduce imports, transfer excessive trade profits to the Government, promote the growth of government-protected industries, and stabilise a minimum level of living for the people. Managing this system required only that Government periodically adjust the dual rates as internal prices changed (Myres, 1990: 46). Thus the regime facilitated economic profits to importers, revenue gains for the Government, and profits for the protected industries.

However, by the middle of the 1950s, these highly effective protectionist measures were beginning to have deleterious side-effects. As industrial production

⁷ The exchange rate applied to essential raw materials and capital equipment imported by end users was NT\$ 15.65 per US\$ in 1953 and NT\$ 36.38 per US\$ in 1958. During this period, the average market rate per US\$ was NT\$ 26.49 in 1953 and NT\$ 46.58 in 1958 (Ho, 1978: 193).

expanded, the finite domestic market for textiles, wood products, and rubber/plastic goods became saturated (Gold, 1990: 72; Long, 1991: 82; Shih, 1994: 92). The rates of capital utilisation in many important manufacturing industries were very low (San, 1991: 34). Between 1955 and 1959 manufacturing and services failed to generate enough new employment to reduce the serious underemployment that existed, and domestic demand did not expand rapidly enough to buy goods and services at prices that enabled firms to remain at full capacity and cover costs. As a corollary, inventories began to rise and overall growth began to decline (from 9 per cent in the early 1950s to 6.5 per cent in the late 1950s) (Chan and Clark, 1992: 82; Myres, 1990: 18-19). In addition, the Government's policy of keeping interest rates artificially low not only created a significant inflationary pressure in the commodity markets, but also failed to attract domestic savings into the capital market. As a result, scarce investible capital was often wasted and misallocated (San, 1991: 34). Price wars ensued, and as production declined so too did demand for the few locally-made capital goods (Gold, 1990: 72). Meanwhile, rigid foreign exchange controls requiring the immediate surrender of all foreign exchange receipts to the BOT discouraged exports (San, 1991: 34). The multiple exchange rate system, by favouring imports of essential raw materials and capital goods, made export competitiveness hard to achieve (Long, 1991: 82). K. Y. Yin,⁸ a leading politician during the 1950s, has pointed out that the over-valued NT\$ lowered the cost of imported goods excessively. Because imports were so restricted and scarce in supply, there was a large discrepancy between the domestic market price of imported goods and their actual cost to importers. Windfall profits were earned by

⁸ K. Y. Yin, also known as Chung-jung Yin, held a number of posts more or less concurrently, including Minister of Economic Affairs (1965-1966); General Manager of the Central Trust of China (1961-1966); Deputy Chairman of TPB (1960-1965); Secretary General of ESB (1968-1969) and Convenor of IDC; Chairman of the Foreign Exchange and Trade Control Commission; Vice-chairman of the Council on U.S. Aid; and Chairman of the Board of the BOT. Yin dominated and forged the broad lines of Taiwan's economic path in the 1950s. The reform of the foreign exchange system which commenced in 1958 was largely due to his foresight and advocacy (Gold, 1990: 68; Myres, 1990: 46; Chiang, 1994: 22 and 25 October 1994; *China Yearbook*, 1960-61: 871; 1961-62: 892).

those lucky enough to obtain their quota of foreign exchange, while entrepreneurs engaged in production who were dependent upon imported raw materials or intermediate goods were penalised (Myres, 1990: 46). However, the Government adamantly refused to “reflate the economy through deficit financing lest inflation be rekindled” (Myres, 1990: 18-19). Instead, it opted for a different course to reallocate scarce resources and to promote sustained economic development.

5.2 Foreign Exchange and Trade Reform

Starting in 1955, the Government strove to simplify its foreign trade and exchange controls (Hsing, 1971: 207). After a hard-fought battle between reformers and those who favoured the status quo, a three-stage reform of the foreign exchange regime began on April 12, 1958, and was completed on August 10, 1959 (Shih, 1994: 94). This reform restructured economic incentives in a number of ways. In 1958, the use of the ‘exchange certificate’ mechanism was extended to virtually all external transactions, and exporters were legally permitted to market their ‘exchange certificates’ at whatever rate they could command⁹ (Hsing, 1971: 207). Furthermore, the manufacturers of exportable goods using imported raw materials were provided with adequate exchange for the direct import of materials and equipment, amounting in many cases to more than the value of their exports. As a result, the market rate of ‘exchange certificates’ was gradually brought down and stabilised. This was followed by the merging of the basic official exchange rate and the official ‘exchange certificate rate’ to form a new basic official exchange rate of NT\$ 36.38 per US\$ on August 10, 1959¹⁰ (Myres, 1990: 46; Hsing, 1971: 207).

⁹ Although the BOT remained in a position to buy any quantity of ‘exchange certificates’ turned in by their holders at the official rate, and to sell them whenever it considered the market rate too far out of line.

¹⁰ For major changes in official exchange rates during the period of 1951-63, see Hsing (1971, 226-229).

This last move ended the confusion caused by the multiple exchange rate system. Taiwan had finally adopted a single exchange-rate system. Under the new system, the Government changed from its original passive stance, of conserving foreign exchange reserves, to one of aggressively creating foreign exchange reserves.

By moving to the single exchange rate, the Government effectively devalued the NT\$ to promote exports¹¹ (San, 1991: 34). With the evolution of the exchange-control system, the degree of import control had increased from 1953 to 1956, but was reduced from 1956 to 1960 following the simplification measures (Hsing, 1971; 207-208). However, the changes were not without risks. Higher-priced imports might generate some price inflation. Other events also threatened to cause inflation: an off-shore artillery exchange with Communist China in August 1958¹² and a giant typhoon that destroyed much of the 1959 crop endangered the economic home front (Ho, 1978: 114). In order to prevent current spending from forcing up prices, the Government in the mid-50s decided to raise surtaxes, and to abolish the low interest rate policy.¹³ Interest rates were subsequently adjusted several times in an effort to curb domestic inflation. As a result, indebtedness of firms jumped in 1960, and many business failures occurred.¹⁴ But demand deposits shot up from NT\$ 925 million in 1960 to NT\$ 2,800 million in 1961, as higher interest rates were paid on savings (Myres, 1990: 47). Moreover, the consumer

¹¹ The NT dollar rate applicable to most traded goods and services was devalued in 1958 from US\$ 1: NT\$ 15.55 to US\$ 1: NT\$ 24.68. In 1960 it was further devalued, and a unified exchange rate of US\$ 1: NT\$ 40 introduced (Long, 1991: 83; Shih, 1994: 94).

¹² The Communists have never abandoned the threat to attack Taiwan with armed forces. Before 1961, there were several important battles such as the Battle of Kinmen (Quemoy) in 1949, and the Kinmen and Matsu Crisis of 1958. Although the Communists' shelling of Kinmen and Matsu continued on an odd-number-day basis, there was a gradual relaxation of tension between two regimes (Ma, 1991: 1).

¹³ The Government decided to abolish the low interest rate was due to the suggestion of S. C. Tsiang, who is now Emeritus Professor of Cornell University and Chairman of the Board of Trustees of the Chung-hua Institution of Economic Research (CIER) (San, 1991: 34, 62).

¹⁴ See, e.g., Lin (1973: 79).

price index was curbed.¹⁵ Scarce investment capital was then allocated in such a way as to ensure fair returns on investment projects (San, 1991: 34). I shall return to this in the next section. In July 1957 the BOT began supplying low-cost export loans to manufacturers on the condition that they would undertake the development of markets abroad. Loans for manufacturers of exports rapidly expanded in the late 1960s and 1970s (Myres, 1990: 35-36). With inflation under control, economic activity resumed (Myres, 1990: 47).

In the meantime, the Government began expanding the list of allowed imports and reducing tariffs. The degree of import control was lowered between 1956 and 1960, with almost all 'suspended imports' being reclassified as 'controlled imports'.¹⁶ At the same time, the tariff rates of 1955 were lowered in 1959 for 13 of the 15 commodity groups; they would be further reduced in 1965 (Tao, 1969: 174-175). In addition, import merchants were no longer given fixed quotas on a case by case basis, but were allowed to apply freely for the import of different categories of commodities within respective total quotas. These total quotas were themselves eventually abolished (Hsing, 1971: 207).

In January 1960, the Government enumerated a '19-Point Programme of Economic and Financial Reform' (hereinafter '19-Point Programme') to help achieve a higher target of rapid industrialisation (Wang, 1985: 109). One of the most important aspects of this programme was the enactment, in September 1960, of the Statute for Encouragement of Investment (SEI). Because the main purpose of the 19-Point Programme was to promote Taiwan's exports, which is the theme of Chapter 6, I shall discuss the 19-Point Reform and the SEI in that chapter.

¹⁵ The consumer price index was 18.8 per cent in 1953, 11.7 per cent in 1954, 9.9 per cent in 1955, 10.5 per cent in 1956, and 7.5 per cent in 1957 (San, 1991: 34; TSDB, 1997: 165).

¹⁶ Total import products in the 'controlled' category increased from 9.35 per cent in 1956 to 40.13 per cent in 1960. Import products in the 'suspended' category decreased from 36.64 per cent in 1956 to 0.32 per cent in 1960 (TSDB, 1997).

5.3 Investment Incentives

The Government policies outlined above completed the reform of the foreign trade control system that brought Taiwan to the threshold of a new era of export expansion. The economy had begun to experience export-led growth. In order to keep the economy on its new course, the Government began to introduce incentives to promote greater domestic saving and investment and to attract more foreign investment.

In order to encourage a high rate of savings by households, private enterprises, and public enterprises, the Government adopted two strategies. The first strategy, already used in the early 1950s and repeated later by the Government, was to raise interest rates for time deposits in banks to ensure positive real rates of return. This strategy proved to be successful, as the ratio of savings to GNP rose from 14.6 per cent in 1955 to 17.8 per cent in 1960, and continued to rise to a peak of 38.5 per cent in 1986 and 1987 (TSDB, 1997: 56). The second strategy was to introduce new tax incentives. In September 1960, for example, the Government exempted recipients of interest earned from time deposits of two years or longer from paying any income tax¹⁷ on that interest (Myres, 1990: 48).

As part of the domestic investment programme, private industries were assigned increasingly larger weight. In 1953, the Government transferred four public corporations to private hands¹⁸ to pay for the land relinquished by former land-owners under the Land-to-the-Tiller Programme (see Chapter 4 above). This move both encouraged private investment and helped to move the attention of former land-owners from agriculture to industry. In the meantime, as an associated incentive, the Government restrained the expansion of activities of public

¹⁷ Article 23 of the 1960 SEI.

¹⁸ This included the Taiwan Cement Corporation, which became one of the largest and most profitable private enterprises in later years (Hsing, 1971: 189).

corporations in order to reserve new investment opportunities for private entrepreneurs. Thus, while retaining overall planning control of industrial development, the Government sought to “enlist private initiative instead of stifling it” (Hsing, 1971: 188-189).

The Government also created new incentives for businesses to invest. As was mentioned in the previous section, in September 1960 the Government passed the Statute for Encouragement of Investment (SEI). Tax benefits included: five-year tax exemptions or accelerated depreciation of fixed assets; investment credits ranging from 10 to 15 per cent; preferential rates on corporation tax ranging from 22 to 25 per cent; and deduction of up to 15 per cent of money paid for acquiring share certificates in any tax year (Sun, 1985: 2). These will be detailed further in Chapter 6.1.2. Exporters also began receiving tax incentives when purchasing raw materials from abroad and importing machinery for producing for exports (Myres, 1990: 48). All this involved a considerable loss of revenue for the Government, but it appears that the incentive given to businesses to undertake more investment and expand sales generated compensating tax revenue of similar or greater levels (Myres, 1990: 49).

5.4 Government Policies on FDI and Laws on Foreign Investment

The Government’s role in the investment process was vital. Indirectly, it introduced incentives to influence both the size and direction of investment. Directly, general government and government enterprises together accounted for 54 per cent of total fixed investment in 1955-1960, and 40 per cent in 1961-1973 (DGBAS, 1973: 210).

One of the stated implications of the *Min-sheng* Principles was to make controlled use of foreign capital to develop domestic wealth-producing assets and

human capital. For this reason, the ROC government had a more positive attitude towards foreign investment in Taiwan's early development stage than many other developing countries. During the primary import-substitution period, foreign capital inflow was mainly in the form of official concessional aid (Lim, 1991: 64; Fei, Ranis and Kuo, 1979: 28; Ranis and Schive, 1985: 90), mostly from the United States which had a political interest in stabilising Taiwan's economy and promoting its growth. A temporary surge of U.S. foreign assistance played an important role in facilitating the structural changes in the Government's economic development strategy, from import substitution to export substitution, that occurred between 1959-1961 (see Chapter 6 below). Foreign aid was required to provide raw material imports in order to permit fuller utilisation of existing industrial capacity. It was also needed to help overcome serious inflationary pressures and foreign exchange shortages. The aid flows provided Taiwan's policy makers with both psychological reassurance and the necessary foreign exchange and domestic credit resources to survive the difficult period of transition in economic policy at the end of the 1950s (Ranis and Schive, 1985: 92).

Apart from temporary official aid from the US, the Government also hoped to attract FDI to help domestic development. During the early 1950s, the ROC's national income was very low; per capita income was less than US\$ 200.¹⁹ The average savings rate was around 10 per cent of national income.²⁰ A savings rate as low as this could not possibly meet the nation's financing needs in the early stages of economic development. Thus it was necessary to attract considerable foreign investment. Moreover, the foreign technology that followed was also essential to help improve domestic manufacturing techniques (Sun and Lee, 1985: 78).

¹⁹ The per capita GNP in Taiwan was US\$ 196 in 1952 and US\$ 203 in 1955 (TSDB, 1997: 32).

²⁰ The average savings rate was 11.9 per cent of national income in 1952 and 11.2 per cent in 1955 (TSDB, 1997: 56).

Foreign investment and technical co-operation could also create job opportunities, improve managerial skills, open overseas markets and relieve the shortages of foreign exchange. In view of all this, as early as July 14, 1954 the Government thought to make use of external private capital by promulgating the Statute for Investment by Foreign Nationals (SIFN), followed by the Statute for Investment by Overseas Chinese (SIOC) on November 19, 1955 (Myres, 1990: 49; Hsing, 1971: 217; IDIC, 1996: SIFN; IDIC, 1996: SIOC). However, the main provisions of these Statutes related to the remittance of investment earnings and repatriation of capital by investors, and to possible disadvantageous effects on local industries (Hsing, 1971: 217). Partly under the pressure of influential domestic industrialists, the Government's attitude towards these two problems was initially rather conservative, and the relevant terms stated in these Statutes were not very attractive to potential investors. With the impending phase-out of U.S. aid in the late 1950s, the Government gradually adopted a more forward-looking and positive attitude towards foreign private investment (Hsing, 1971: 218). The Government began to make efforts to improve investment incentives in order to attract more FDI, and attempted to direct FDI toward preferred industries, primarily those in manufacturing (Ho, 1978: 239). This led to revision of the SIFN on December 14, 1959²¹ and of the SIOC on March 26, 1960.²² The revised laws encouraged foreign investment to locate in Taiwan by instituting a greater range of statutory protection for investments, and by making it possible for the investor to apply each year to remit foreign exchange to his home country. Article 13 of 1959 SIFN, for example, stipulated that foreign investors could apply for repatriation of capital for any amount up to 15 per cent of the total sum invested. Such application could only be

²¹ After its initial promulgation, SIFN was amended on December 14, 1959, January 8, 1968, June 22, 1968, July 27, 1979, April 3, 1980, May 9, 1980, May 11, 1983, May 14, 1986, and May 26, 1989 (IDIC, 1996: SIFN).

²² After its initial promulgation, SIOC was amended on March 26, 1960, January 8, 1968, June 22, 1968, July 18, 1979, May 9, 1980, May 11, 1983, June 2, 1986, and May 26, 1989 (IDIC, 1996: SIOC).

made two years after Government approval of the original investment plan. But even that 15 per cent share could be raised if the Government approved, with approval largely depending upon the available foreign exchange reserves. Moreover, investors could apply for the remittance of the whole amount of investment earnings (net profit or interest) two years after the completion of the approved investment in accordance with the Article 13 of the 1959 SIFN and Article 12 of the 1960 SIOC. The remittance of investment earnings had been limited to 15 per cent of the investment capital in the 1954 SIFN and 1955 SIOC. The amended laws also gave extensive protection against expropriation. Article 16 of the 1959 SIFN and Article 15 of the 1960 SIOC guaranteed investors that the enterprise would not be subject to requisition or expropriation for a period of 20 years after commencement of business, as long as the investor continued to hold 51 per cent or more of the total capital.²³ The guarantee against requisition or expropriation had been only 10 years in the 1955 SIOC.

More importantly, the Government promulgated the Statute for Encouragement of Investment (SEI) on September 10, 1960, and its Enforcement Rules (ERSEI) on January 11, 1961 (IDIC, 1990: SEI; IDIC, 1990: ERSEI). The SEI provided a variety of incentives, and covered not only investments by foreign nationals and overseas Chinese, but also those by local residents: reflecting the recognition that, in the long run, it is more important to encourage domestic savings and investment than to bring in investment from abroad. The major aim of the 1960 SEI was to eliminate existing laws and regulations that hampered investment activity and to stimulate investment through tax deductions and exemptions (Sun and Lee, 1985: 79). This will be further discussed in Chapter 6.

²³ Article 16 of the 1959 SIFN: "In case the investor's investment is 51 per cent or more of the total capital of the enterprise in which he invests, such an enterprise shall not be subject to requisition or expropriation for a period of twenty years after commencement of business as long as the investor continues to hold 45 per cent or more of the total capital."

It should be mentioned here that, at a time when many developing countries were concluding state contracts in natural resources or other sectors,²⁴ Taiwan was not. This was largely because the country does not have extensive natural resources sectors (see Chapter 2 above). Furthermore, compared with Malaysia, Indonesia and African countries, Taiwan had more sophisticated human resources (for reasons discussed in Chapter 4 above) than many other developing countries, and so was able to carry out many infrastructure projects without foreign contractors.

5.5 FDI during the Primary Import-Substitution Phase

Before analysing FDI in Taiwan, three important points need to be made. First, the term FDI, as used in Taiwan's statistical data does not take account of the problem of 'control'. In other words, as long as the invested capital is not entirely owned by a ROC citizen, it is treated as foreign investment. Some famous companies in Taiwan, such as Ta-tung Company and Taiwan Cement Company, two of Taiwan's top ten private businesses, are counted as FDI companies because those companies have some foreign capital, even though the amount of invested capital is very little, and whether or not the investment is from overseas Chinese (Bello and Rosenfels, 1990: 237; Cohen, 1989). Therefore the effects of FDI on Taiwan's economy are very often over-estimated by statistical data. Secondly, the amount of approved FDI may differ from the amount of FDI actually contributed by foreign investors because approved FDI does not always come eventually to Taiwan. Many scholars like to analyse approved FDI because the relevant information is more complete and easier to obtain than is information regarding the FDI that actually arrived. One must distinguish the two. For example, FDI applications were approved for the establishment of China Steel Company and China Shipbuilding Company, but the actual investment did not arrive in either case

²⁴ For state contracts, see, generally, Paasivirta (1990), Sornarajah (1990), and Kuusi (1976).

(Schive, 1994: 415). In general, the amount of approved FDI is more than twice that of arrived FDI (see table 5.1). Thirdly, the Investment Commission's statistics do not include investment through branches in Taiwan (Liu, 1994: 132).

The earliest FDI approved by the Ministry of Economic Affairs (MOEA) was an investment made by the American company, General Electric (GE) in 1953 (Schive, 1994: 416).²⁵ However, the total amount of FDI arriving in Taiwan during the 1950s was very little and irregular (TSDB, 1997: 242). This is probably due to a number of reasons: (1) The Government adopted an import-substitution policy in this period. This was unattractive to foreign investors because the size of the domestic market in Taiwan was too small for significant profit (Yü, 1985: 13). (2) Owing to a lack of foreign exchange, the Government employed a strict import controls system in the 1950s. (3) These controls were relaxed only with respect to Overseas Chinese. Following the 1952 "Rules Governing Encouragement of Overseas Chinese, Hong Kong Chinese and Macau Chinese Establishing Productive Enterprises", and the 1952 "Rules Governing Products Imported for Establishing Productive Enterprises Against Self-Provided Foreign Exchange", Overseas Chinese were allowed to import products in 'controlled' and 'suspended' categories against their self-provided foreign exchange as capital stock (TIER, 1993: 17; Yü, 1985: 12). However, quite apart from their limited application, even these legal incentives produced only an unstable inflow of foreign capital in the 1950s, as many overseas Chinese investors were opportunists rather than long-term investors (Schive, 1994: 416). The 1952 Rules were consequently annulled in 1958 (Chiang, 1994; Yü, 1985: 13). Their role can probably explain why the amount of arrived FDI increased dramatically from US\$ 2.4 million in 1957 to US\$ 11.71 million in 1958, then dropped sharply to US\$ 3.78 million in 1959 (see table 5.1). (4) In the 1950s, private investors were uncertain of Taiwan's political and economic future. After the Chinese Communist army attacked Quemoy in late

²⁵ The first MOEA-approved investment made by overseas Chinese was in 1952 (Yü, 1985: 12).

1954, private investment plunged. As a share of total fixed investment, it declined from 63 per cent in 1954 to 46 per cent in 1955, in a period when total arrived FDI declined from US\$ 9.91 million to US\$ 0.51 million (see table 5.1). Private investors did not become confident in Taiwan again until the Nationalist army decisively repulsed a second major communist assault on Quemoy in 1959 (Ho, 1978: 235).

Between 1953 and 1960, FDI by non-Chinese foreigners amounted to 70 per cent (62 per cent from the US and 8 per cent from Japan) of total foreign investment, with only 30 per cent made by overseas Chinese (see table 5.2). During this period, 80 per cent of overseas Chinese invested in construction and services, within which banking played a very important role. The virtual absence of non-overseas Chinese FDI in construction and services was due to restrictions against branch banking by non-Chinese investors, and to the fact that investment in construction and public utilities was off-limits to such foreigners unless they were willing to waive their foreign exchange settlement privileges (Ranis and Schive, 1985: 103-105). In contrast, non-Chinese foreign investors invested mainly in import-substitution light industries, in order to exploit Taiwan's cheap labour supply (IDIC: *Industry and Investment*, October 1994: 4). This discriminatory treatment reflected the fact that the Government was at that time not confident enough to open its domestic market equally to foreign and overseas Chinese investors.

5.6 Conclusion

The foregoing discussion suggests that much of Taiwan's initial success can be attributed to the relative mildness and flexibility of its regime of primary import-substitution. The policies Taiwan chose during the 1950s to effect the desired re-direction of resources seem quite standard for developing countries (Fei, Ranis and

Kuo, 1979: 26). Deficit financing by Government and substantial rates of inflation accompanied the classic phenomena of over-valued exchange rates, protective exchange controls, import licensing, and low interest rates, all slanted to assist the new industrial entrepreneurial class (Fei, Ranis and Kuo, 1979: 27). By LDC standards, however, Taiwan experienced a relatively mild version of this primary import-substitution policy package (Ranis and Schive, 1985: 90). The Government started further economic reform in the late 1950s in order to enhance production efficiency. The foreign exchange and trade reform was successful, in that it led to Taiwan's rapid growth of foreign trade in the 1960s. Although FDI during this period was not very important in terms of the amount of investment capital, the Government at least realised the importance of FDI and amended its investment law governing foreign investors. This helped Taiwan's economic development a great deal in the primary export-substitution phase which will be examined in the next chapter.

Table 5.1 A Comparison of Approved FDI and Arrived FDI in Taiwan²⁶

Amount unit: US\$ 1,000,000

Year	Approved FDI	Arrived FDI ²⁷
1952	1.07	0.62
1953	3.70	2.11
1954	2.22	9.91
1955	4.60	0.51
1956	3.49	0.66
1957	1.62	2.40
1958	2.52	11.71
1959	0.69	3.78
1960	15.47	5.77
1961	14.30	9.46
1962	5.20	8.98
1963	18.05	15.23
1964	19.90	15.57
1965	41.61	10.51
1966	29.28	9.59
1967	57.01	27.87
1968	89.89	27.89
1969	109.44	51.52
1970	138.90	61.93
1971	162.96	52.63
1972	126.66	36.37
1973	248.85	67.79
1974	189.38	104.05
1975	118.17	70.57
1976	141.52	90.71
1977	163.91	76.50
1978	212.93	129.74
1979	328.83	120.86
1980	465.96	190.83
1981	395.76	156.50
1982	380.01	149.18
1983	404.47	175.40
1984	558.74	231.59
1985	702.46	343.68
1986	770.38	350.22
1987	1418.80	847.92
1988	1182.54	1231.36
1989	2418.30	-
1990	2301.77	-
1991	1778.42	-
1992	1461.37	-
1993	1213.48	-
1994	1630.72	-
1995	2925.34	-
1996	2460.84	-

²⁶ Source: The Central Bank of Taiwan (1996) *Balance of Payments*; Council of Economic Planning and Development (1996); Investment Commission, MOEA (1996) *Statistics on Overseas Chinese & Foreign Investment, Technical Co-operation, Outward Investment, Outward Technical Co-operation*.

²⁷ Unfortunately, even through private channels, the amounts of arrived FDI between 1989 and 1996 are not yet publicly available at time of writing.

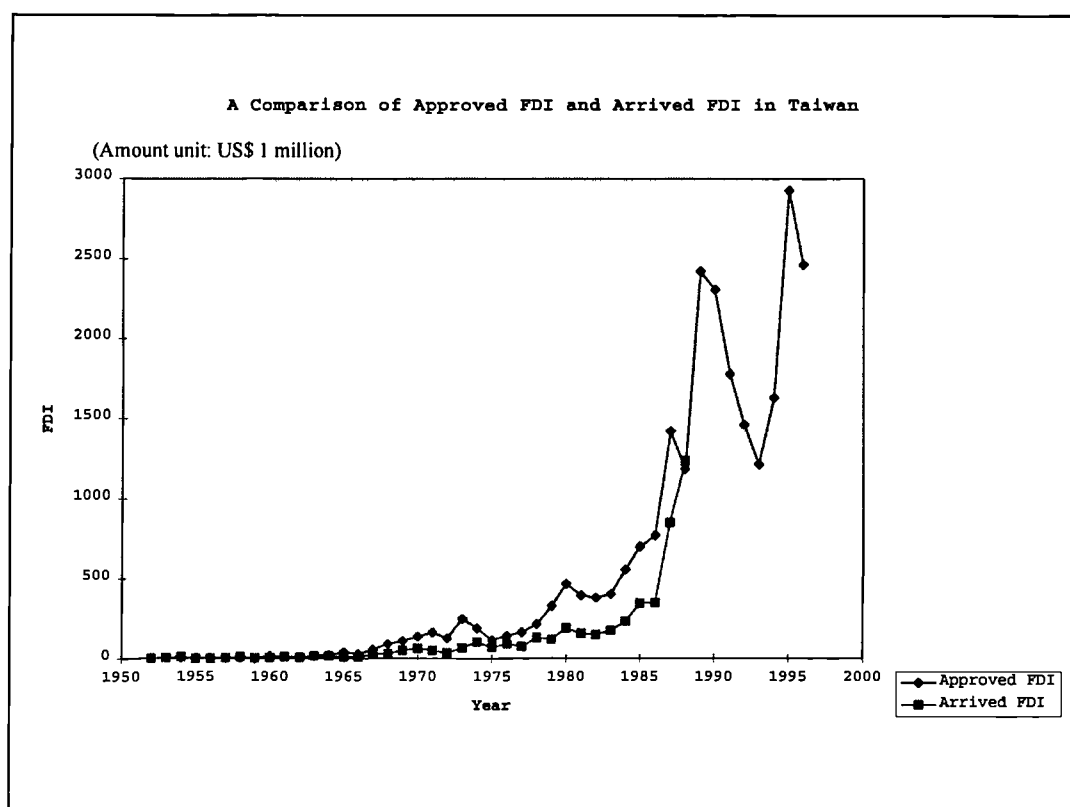


Table 5.2 Overseas Chinese & Private Foreign Investment in Approvals²⁸

		Amount unit: US\$ 1,000,000 (%)						
Period		OCI*	PFI*	USA	Japan	Europe	Others	Total
1952-1960	amount	10 (30)	23(70)	21(62)	2(8)	--	0(0)	33(100)
	case	58(70)	23(30)	12(16)	10(13)	--	1(1)	82(100)
1961-1970	amount	153(29)	373(71)	221(42)	87(16)	36(7)	29(6)	526(100)
	case	674(53)	564(47)	144(12)	376(31)	16(1)	28(2)	1211(100)
1971-1980	amount	801(37)	1358(63)	534(25)	369(17)	225(10)	230(11)	2159(100)
	case	774(53)	675(47)	173(12)	370(26)	46(3)	86(6)	1449(100)
1981-1990	amount	989(9)	9544(91)	2510(24)	3224(31)	1703(16)	2107(20)	10533(100)
	case	713(23)	2323(71)	481(16)	1063(35)	320(11)	459(15)	3036(100)
1991-1995	amount	931(10)	8079(90)	2549(28)	2177(24)	1115(13)	2238(25)	9010(100)
	case	300(16)	1626(84)	302(16)	615(32)	204(10)	505(26)	1926(100)
1952-1995	amount	2884(13)	19377(87)	5836(26)	5859(26)	2707(12)	4975(23)	22261(100)
	case	2482(32)	5215(68)	1112(14)	2435(32)	553(7)	1115(15)	7697(100)

*OCI is abbreviated for overseas Chinese investment; PFI is abbreviated for private foreign investment.

²⁸ Source: TSDB (1997: 242-244); The Central Bank of Taiwan (1996) *Balance of Payments*; Council of Economic Planning and Development (1996); Investment Commission, MOEA (1996) *Statistics on Overseas Chinese & Foreign Investment, Technical Co-operation, Outward Investment, Outward Technical Co-operation*.

Chapter 6

Law, Policy and FDI during the Primary Export-Substitution Phase, 1961-1972

At the end of the primary import-substitution phase, most developing countries are confronted with two choices. One is to continue import substitution and extend it into heavy industries; the other is to attempt to shift the focus of industrial activity toward export-led markets (Chan and Clark, 1992: 83). The majority of developing countries in Latin America and Asia followed the first course. Taiwan belongs to that small group of exceptions which moved into a primary export-substitution pattern (Huang, 1989: 99, Ranis and Schive, 1985: 92; Ho, 1978: 187). The primary objectives of Taiwan's economic policies in the 1960s were export promotion and encouragement of investment in labour-intensive industries. As will be shown in the succeeding sections, export expansion was a decisive factor in the successful, rapid industrial growth of the 1960s and 1970s.

Gold (1990: 74-76) has analyzed the reasons why Taiwan opted for a different approach from Latin American countries in the 1960s. First, the Government in Taiwan played a major direct role in the economy. It dominated the heights¹ of the economy and directly controlled a sizeable and crucial portion of industrial output. Little FDI was linked to the state sector. Extensive import prohibitions severely restricted a foreign presence. Thus, unlike most Latin American countries, any new policies to resolve import-substitution problems

¹ The state's presence in the economy must be evaluated not only in quantitative terms but also in terms of its qualitative relationship to the rest of the economy. The tremendous influence of the state sector stems from the fact that it controls the "commanding heights of the economy", to use Lenin's terms, either by monopolizing public utilities or by occupying the leading positions in key oligopolistic sectors (Bello and Rosenfeld, 1990: 233; Huang, 1986: 137-138).

would not have to consider the wishes of the multinational enterprises (MNEs).² Secondly, Taiwan had been isolated from the world capitalist system since 1949. On the one hand, substantial material, financial and military aid from the US meant Taiwan had no need to trade with other countries. On the other hand, protectionist measures during the primary import-substitution phase limited the foreign presence in Taiwan (see Chapter 4 and 5 above). Lacking both domestic foreign interests and external economic pressures, the Government had more flexibility to determine its relationship with the outside, especially given U.S. cooperation and assistance. By contrast, the Latin American economies had been incorporated into the world system for a long time through FDI, finance, and trade, and the governments' ability to implement policies was therefore more constrained. Thirdly, the Government in Taiwan was dominant economically and politically, as well as internally united. There was little chance of popular resistance to its policies. However, Latin American governments were in a weak position regarding their own civil societies and economies. In addition to these considerations, moreover, there is one important factor - mentioned in the previous chapter - that Gold has missed: the size of the domestic market in Taiwan was very limited. As that domestic market became saturated, the need for foreign exchange earnings grew urgent in the late 1950s and new policies favouring export expansion were required.

Indeed, although Taiwan's economic development made considerable advances during the 1950s, the domestic market for products of its manufacturing industries had reached saturation point by the end of the decade. In order to maintain growth, either the manufacturing sector had to move into intermediate and capital goods production in order to replace imports of those products, or the recently established import-substitution activities, primarily in non-durable consumer goods, had to penetrate the world market (Ho, 1978: 195). The former

² I use the term, multinational enterprise (MNE), broadly to describe 'a corporation or enterprise that owns and controls productive activities in more than one country'.

option would require a great deal of capital in order to develop capital-intensive high-technology industries. The latter choice, being the policy adopted by Japan between 1900 and 1920, needed cheap labour in order to develop labour-intensive light industries (Shih, 1994: 92-93). But, given the existing highly protectionist policy and the prevailing industrial environment, neither alternative seemed likely to succeed. At the same time, the US aid policy was changing gradually so that it could not be depended upon over the long term, and the need for self-sufficient growth became more pressing year by year (Sun and Lee, 1985: 60).

In view of this, the Government decided to abandon continued development of primary import-substitution, and switched its efforts to promoting the export of products of labour-intensive industries in order to expand the scale of production (Sun and Lee, 1985: 66). With encouragement from the local US AID Mission,³ the Government began in 1958 to rationalize the existing import-substitution policy package and to reduce, if not remove, some of its discriminatory features against the export sector (Ho, 1978: 195). Freed from these bonds, local businessmen could act more effectively (Woronoff, 1992: 67).

It is important to emphasise that export-oriented substitution did not mean the end of import-substitution industries, but rather the evolution of a close relationship whereby local capital now produced, largely for export, the parts, components, and finished goods that were previously produced for domestic consumption. Towards this end, the Government took the lead in opening new foreign markets, soliciting FDI, linking domestic and foreign capital, and fine-tuning the investment climate (Gold, 1988a: 185).

³ The reforms were made partly because U.S. advisers threatened a reduction in aid should the Government not adopt the reform package, while offering a US\$ 20-30 million 'carrot' for prompt implementation; and partly because many Western-trained economists and government officers supported the new policies (Jacoby, 1966: 134-135; Hsing, 1971: 199; Gold, 1990: 77; Long, 1991: 83; Huang, 1989: 99; Woronoff, 1992: 66-67).

6.1 Financial and Economic Reform

Between 1958 and 1963 the Government initiated numerous reforms and new programmes, with two central aims: the encouragement of private investment and the promotion of exports. These two strategies were to prove highly effective in helping to bring about rapid industrialisation (Long, 1991: 83).

6.1.1 19-Point Programme

One of the most significant developments in this period was the adoption of the 19-Point Programme of Financial and Economic Reform (hereafter referred to as the 19-Point Programme) by the Executive Yuan in January 1960.⁴ This programme included proposals to encourage savings and private investment, remove controls and hidden subsidies, strengthen the tax system and tax administration, improve the Government's budget system, develop money and capital markets, establish a unitary foreign exchange rate, liberalise controls on exchange and trade, promote the development of trade, raise public utility rates, reduce tariffs on imported inputs, revise import duties, provide rebates if the products were exported, liberalise trade regulations, and retain military expenditures (Jacoby, 1966: 134-135; Gold, 1990: 77; Lin, 1973: Chapter 5; Sun, 1969: 26-38; Fong, 1968: 365-425; Wang, 1985: 109).

The most important of the financial reforms was the abolition of the complex multiple exchange rate system. This measure, accompanied by devaluation of the New Taiwan dollar, ended one of the most discriminatory features of Taiwan's import-substitution policy. The local currency was pegged at US\$1: NT\$

⁴ The 19-Point Programme derived from an 8-Point Programme proposed by the AID Mission in 1959 in order to speed economic development and push Taiwan toward 'graduation' from foreign aid. This 8-Point Programme included: a non-inflationary, fiscal and monetary policy, tax reform, unification of foreign exchange rates, liberalized exchange controls, establishment of a utilities commission and of investment banking machinery, and also the sale of government enterprises to private owners (Jacoby, 1966: 134-135). The 19-Point Programme was incorporated in Taiwan's third Four Year Plan (1961-1964) (Shih, 1994: 93).

40 until 1973, and only after September 1985 did it rise appreciably from what was by then an artificially low level (Long, 1991: 83).

The 19-Point Programme covered a range of further liberalisation measures. The allocation of foreign exchange for permissible imports was simplified and rationalised. Some goods on the controlled and suspended lists were decontrolled, and more stringent criteria were established to screen products for the controlled list (Ho, 1978: 196). Between 1957 and 1970 a total of 1,471 items that had been on the restricted import list were removed (Lin, 1973: 93). With these actions the Government reduced the level of protection on a large number of non-durable consumer goods and relied increasingly on tariffs rather than quotas to restrict imports (Hsing, 1971: 242-243). Import duties were also slashed. By 1965, the average import tariff rate had fallen to 35 per cent, from 47 per cent in 1955 (Long, 1991: 83).

Existing export promotion schemes were expanded and strengthened and new ones introduced. Loans from the public sector banks to exporters were offered at low preferential rates, and credit was made easier for exporters (Sun and Lee, 1985: 61; Long, 1991: 83; Kuo, Ranis and Fei, 1981: 79-80; Shih, 1994: 94). One of the most important export promotion schemes to be introduced was the tax rebate system, which avoided complicated administrative procedures. The Government helped exporters by remitting various taxes and rebating taxes incurred on materials re-exported in the form of manufactured products⁵ (Long, 1991: 83; Ho, 1978: 196; Kuo, Ranis, and Fei, 1981: 75-76). Under this system, the local producers of these materials could sell them to the exporter at the lower world price, and would then be entitled to claim the amount of tariff duties and other taxes that the exporter would have paid had he imported instead (Ni, 1987: 265-267).

⁵ This tax incentive was first introduced in the early 1950s for imported materials used in a few exportable handicraft exports. It was expanded eventually to all exports with the remission broadened to include, besides custom duties, commodity tax, defense surtax, harbour dues, salt tax, and slaughter tax (Ho, 1978: 196; Hsing, 1971: 213).

This had the effect of encouraging Taiwan's exporters to be internationally competitive while protecting domestic materials producers (Chin, 1988: 100). Taxes on imported materials for manufactured exports were permitted to be unpaid for the intervening period before re-export, upon a guarantee being provided by financial institutions, or upon the factories themselves handing in government bonds of equivalent value to the responsible agency (Hsing, 1971: 213). From NT\$ 39.3 million in 1956, remission of taxes on raw materials used in producing industrial exports climbed rapidly to NT\$ 303 million in 1960, NT\$ 1,496 million in 1964, and NT\$ 2,320 million in 1967⁶ (DSMOF, 1980; Lin, 1973: 104). Correspondingly, the nominal rate of protection⁷ dropped considerably in the 1960s (Kuo, 1979: Appendix II A). Income taxes were also reduced to encourage capital formation (Long, 1991: 83). As a result of the Statute for Encouragement of Investment (see Chapter 6.1.2 below) and the tax and duty rebates for export activities, a large proportion of the gross tax burden was reduced (Kuo, Ranis and Fei, 1981: 75). To regulate production and to promote the orderly expansion of export industries, the Government approved and supported the formation of export cartels⁸ and, on occasion, it also restricted investments in overexpanded industries (Hsing, 1971: 203; Lin, 1973: appendix table A-26). The success of the 19-Point Programme was a major factor leading to Taiwan's rapid growth in foreign trade during the 1960s and to the island's success as an 'economic miracle'.

⁶ Note that the official exchange rate for the US dollar was NT\$ 24.78 in 1956 and NT\$ 40.10 in 1967, while the market rate was NT\$ 38.35 and NT\$ 41.50 respectively in the two years (Lin, 1973: 104).

⁷ The nominal rate of protection is 'the actual amount of protection accorded to domestic suppliers of a final product when a tariff is applied to a competing imported final product' (Pass, Lowes and Davies, 1988: 359). A higher rate of nominal protection means a higher degree of protection (Kuo, Ranis and Fei, 1981: 77).

⁸ In 1972, industries with cartel arrangements included cotton and wollen textiles, paper, steel products, rubber products, monosodium glutamate, cement, canned mushrooms and asparagus, and citronella oil. Production was regulated by the allocation of export quotas (Ho, 1978: 196).

6.1.2 1960 Statute for Encouragement of Investment

The Statute for Encouragement of Investment (SEI) was promulgated in 1960. The SEI,⁹ which aimed to facilitate the acquisition of plant sites¹⁰ and to provide production incentives through tax exemptions and deductions, was enacted pursuant to the 19-Point Programme (Kuo, Ranis and Fei, 1981: 75). It offered various incentives to both domestic and foreign investors, and has since become a standard package of investment incentives offered by developing countries (Long, 1991: 83). It dealt with three main areas: (1) tax benefits (including a five-year tax exemption from business income tax) and other incentives (such as accelerated depreciation) to encourage domestic and overseas investors (Chapter II of SEI); (2) facilities for acquiring adequate plant sites (Chapter III of SEI); and (3) coordination between development of public and private enterprises (Chapter IV of SEI). In the SEI, a five-year tax holiday was the strongest production incentive for those new enterprises which were operating in target industries ('productive enterprises'¹¹) or for those existing enterprises which expanded productive capacity by 30 per cent (Article 5). Those productive enterprises would also benefit from a reduced top rate of corporate income tax, of 15 per cent, and the maximum rate of income tax was not to exceed 18 per cent of its total annual income, compared to 32.5 per cent for ordinary profit-seeking enterprises (Article 15). Productive

⁹ The SEI was promulgated on September 10, 1960 and amended on January 4, 1965, June, 1965, March 31, 1967, December 30, 1970, March 22, 1973, December 29, 1973, December 30, 1974, July 26, 1977, December 30, 1978, January 19, 1979, July 20, 1979, December 30, 1980, July 26, 1982, December 30, 1984 and January 26, 1987 (IDIC, 1990: SEI). The SEI was annulled on December 31, 1990 and replaced by Statute for Upgrading Industries.

¹⁰ Besides the tax concessions, the Statute also removed several serious obstacles imposed by the existing land reform legislation on the acquisition of land for industrial use (Ho, 1978: 243).

¹¹ 'Productive enterprises', according to Article 3 of the 1960 SEI, included Manufacturing, Handicraft, Mining, Agriculture, Forestry, Fishery, Animal Husbandry, Transportation, Warehousing, Public Utilities, Public Housing Construction, Technical Services, and Heavy Machinery. In 1967, revision of the SEI added international tourism to the list. 'Public Facility Construction and Development' was added in 1984, in order to encourage private investment in public facilities within urban plan areas.

enterprises with foreign currency debt were allowed to set aside up to 7 per cent of pre-tax profits as a reserve against foreign exchange rate fluctuation. The stamp tax was waived or reduced in many cases (Article 28, 32, and 38). In addition, for all enterprises, re-invested profits of up to 25 per cent of total income were allowed to be offset against tax, as were 2 per cent of annual export proceeds (Article 29). Unquestionably, these incentives helped to create an environment more conducive to export production. When combined with the launch of the 19-Point Programme, the SEI established a new economic policy regime for Taiwan (Huang, 1989: 99). Major changes in other regulations¹² were contained in Regulations Governing Sale and Purchase of Foreign Exchange Certificates,¹³ Regulations Governing the Application for Import Exchange by Private Traders,¹⁴ Criteria Governing the Control of Imports,¹⁵ Regulations for Promoting Exports of Products Processed with Imported Raw Materials,¹⁶ and Regulations Governing the Offsetting or Refund of Duties and Taxes on the Raw Materials of Export Products.¹⁷

Despite these measures, the response of industry to export expansion in the early 1960s was not very fast (Kuo, Ranis and Fei, 1981: 75). Thus further reforms followed. The SEI itself was revised in 1965, 1967 and 1970, and its scope expanded (see Chapter 6.2.1 below). In 1962 the Statute for Technical Cooperation (STC) was promulgated¹⁸ pursuant to para. 2, Article 4 of the SIOC and SIFN.¹⁹

¹² For discussions of these reforms, see Sun (1969: 26-38); Chou (1969); Fong (1968: 365-425) and Lin (1973).

¹³ Promulgated on April 14, 1958, and revised on December 12, 1958, and August 8 1959.

¹⁴ Promulgated on April 13, 1958, and revised on July 27, 1960.

¹⁵ Promulgated on July 27, 1960.

¹⁶ Promulgated on September 12, 1959.

¹⁷ Promulgated on December 26, 1958.

¹⁸ Promulgated on August 9, 1962 and amended on May 29, 1964.

¹⁹ Para. 2, Article 4 of the SIOC and SIFN: 'Cooperation in the form of furnishing technical know-how or patent rights not as capital stock shall be prescribed by other law.'

This law was aimed at bringing in foreign technology and making it take root in Taiwan (Sun and Lee, 1985: 79). In 1965 bonded warehouse²⁰ and bonded factory²¹ systems were instituted.²² By February 1968 nine financial institutions were authorised to set up fourteen bonded factories and seventy-nine bonded warehouses. Imported materials for the production of various exportable goods were brought under this scheme (Hsing, 1971: 213). Additionally, in 1965 the Government established regulations to allow for the designation of export processing zones (EPZs) (see Chapter 6.3 below). This led to the creation of Taiwan's three EPZs, which have played a major role in promoting FDI in Taiwan (Sun and Lee, 1985: 79). Since this time, Taiwan's economy has become increasingly reliant on exports for its growth.

The Government revised its tax laws in 1969. It is worth noting that Taiwan's tax system was characterised by an excessive dependence on indirect taxes,²³ which on the whole were not only regressive but also inelastic in yield as income rose (Ho, 1978: 240). The problem was worsened by the fact that a series of ambiguities and obvious inconsistencies in the tax laws encouraged many business

²⁰ A warehouse that is approved and registered by Customs to store bonded goods is a bonded warehouse (Article 1 of the Regulation Governing the Establishment and Management of Bonded Warehouses). In accordance with Article 35 of the Customs Law, when goods arrive at a port in ROC, the consignee may apply to the Customs for entry into a bonded warehouse, and these goods may be re-exported free of import duty.

²¹ In accordance with Article 35-1 of the Customs Law, export processing factories may be registered as bonded factories under Customs supervision. All imported raw materials stored and used in such bonded factories for manufacturing or processing into finished products for export were exempt from customs duty.

²² The systems were backed by Regulations Governing the Establishment and Management of Bonded Warehouse promulgated in October 1965. It was amended per the Decree of the Ministry of Finance, Ref. No. Tai-Tsai-Kuan-791234537, dated September 4, 1990 and Ref. No. Tai-Tsai-Kuan-841729900, dated January 10, 1996 (IDIC, RGEMBW, 1996).

²³ Indirect taxes produced nearly 80 per cent of Taiwan's total tax revenue in the 1950s and 1960s. (Executive Yuan Tax Reform Commission, 1970: Part I, p.56). United Nations Conference on Trade and Development (UNCTAD) found Taiwan's tax system to be the most dependent on indirect taxes of the 32 LDCs it investigated (UNCTAD, 1967).

enterprises to evade business income tax and thus kept its yield low.²⁴ In the late 1960s the Government became convinced that if it were to play a more active role in the economy, the revenue system had to be improved and made more dependent on direct taxes. In early 1969 the income tax laws were revised and a new rate structure promulgated.²⁵ In effect, the tax reform reduced the tax burden on small businesses and individuals with relatively low income, and increased the income tax on larger firms and persons with high income (Ho, 1978: 242) - partly offsetting the benefits to large firms of the SEI reforms at the beginning of the decade.

The Government also made an important institutional reform in the 1960s. In 1963, to prepare for AID's gradual withdrawal, the Council of International Economic Cooperation and Development (CIECD) was established out of the ESB, and was finally institutionalised in the Economic Planning Council (EPC) of 1973 and in today's Council for Economic Planning and Development (CPED) of 1977 (Woronoff, 1992: 67). The CIECD was a centralised development agency, under the control of the Premier, that amalgamated the Council for US Aid (CUSA) and three planning groups (industrial, agricultural, and communications) (Gold, 1990: 78; Hsing, 1971: 189). The CIECD, which formulated the fourth (1965-1968) and fifth (1969-1972) plans as well as a Ten-Year Plan (1965-1974), coordinated the policies of the relevant ministries and oversaw the implementation of selected projects (Woronoff, 1992: 67). It was originally charged with the formulation, integration, and coordination of economic development plans, and with negotiations for external financial and technical assistance (Myres, 1990: 53). More generally, it represented a commitment by the Government to centralised planning

²⁴ For example, unlike the treatment accorded corporations, the undistributed profits of unincorporated enterprises were considered personal income and therefore were subject to the personal income tax as well. Since those in this category could not pay the business income tax without also being liable for personal income tax, there was a built-in incentive for unincorporated enterprises to avoid paying either of these taxes.

²⁵ For a more detailed discussion of the adopted revisions, see the report of the Executive Yuan Tax Reform Commission (1970, Part I, Consolidated Report: 45-104).

and coordination as well as to “Taiwan’s new position in the world economy outside the US economic womb” (Gold, 1990: 78). The Government also took measures to promote the private sector, such as establishing the Industrial Development and Investment Centre (IDIC) and the China Development Corporation (Gold, 1990. 77-78).

With the guidance of these policies and the continued prosperity of the world economy, exports increased rapidly. Products such as textiles, plywood, plastics, and electrical goods became major forces in exports leading to the ROC economy’s high level of growth and prosperity in the 1960s (Lee, 1984). From 1961 to 1972 - the period of the third, fourth, and fifth Four-Year Economic Plans - the annual export growth averaged 27.4 per cent, while the average annual rate of inflation was only 3.3 per cent, thereby achieving the dual goals of stability and growth (TSDB, 1997: 204). At the same time industry became the main component of economic production, and the proportion of industrial production in the net domestic product grew from 24.9 per cent in 1960 to 40.4 per cent in 1972 (TSDB, 1997: 80). The Third, Fourth and Fifth Four-Year Economic Plans incorporated the 19-Point Programme as well as the 1960 SEI, and offered incentives to stimulate private investment, both domestic and international (Kuo, Ranis, and Fei, 1981: 74). By 1965, when U.S. assistance to Taiwan was terminated, FDI had begun to achieve its own momentum. Eventually, FDI replaced aid as the catalytic element in Taiwan’s development (Simon, 1987; Simon, 1990: 148).

6.2 Government Policy and the Reform of the Laws of Foerign Investment

Before discussing the Government’s policies on FDI between 1961 and 1972, several economic and political developments of the time need to be noted. First, negotiations for the termination of US aid began in the early 1960s, leading to

the virtual cessation of aid flows in 1965. As US aid came to an end, FDI increasingly took its place in importance (Ranis and Schive, 1985: 93). Secondly, in the 1960s, the Government's economic policy was guided by the need to keep economic growth going after the exhaustion of the import-substitution industrialisation process of the 1950s (Bello and Rosenfeld, 1990: 246). The Government therefore sought to combine cheap Taiwanese labour with foreign capital in order to achieve its export-substitution policy and associated industrialisation. Thirdly, the Government wanted to secure Taiwan's position in the world economy (Woronoff, 1992: 78). Attracting foreign capital was seen by the Government as a way to enmesh foreign interests with the interests of Taiwan, making it more difficult for mainland China to isolate Taiwan internationally (Huang, 1986: 192-193). Hence, the Government adopted an 'open' policy towards FDI in the 1960s, using both export orientation and FDI to stimulate industrialisation (Kuo, Ranis, and Fei, 1981: 73-74).

This policy was dependent on the belief that FDI makes an important contribution to economic development. FDI has not only provided an effective channel for capital, industrial know-how, management and marketing to enter the country, but has also resourced initiatives for new branches of industry, vocational training, market analyses, and the financial sector (Cälli, 1980). In order to facilitate FDI, the Government enacted several regulations designed to promote foreign and domestic investment; and a number of government agencies, such as the Investment Commission, IDIC, and Working Group for Helping Hong Kong and Macao Chinese to Invest in Taiwan, were established to provide services and help to investors (Wu, 1993: 31; Woronoff, 1992: 78). The Government especially welcomed FDI in export-oriented industries and different incentives, such as cheap credit and rebates on imported components and raw materials, were made available to exporters (see Chapter 6.1 above) in part to attract FDI (MOEA, Taiwan Industrial Panorama, 1994: vol 153: 4). Investment procedures were simplified and

export processing zones (see Chapter 6.3 below) were also instituted as part of the package to attract foreign investors.

Together with these economic policies, the Government also implemented legal reform of its investment laws during the 1960s to complement its FDI policy.

6.2.1 The Revision of Statute for Encouragement of Investment

The Government amended the SEI in 1965 (twice), 1967 and again in 1970 in order to remove difficulties encountered in the encouragement of investment since the introduction of the law in 1960. For example, the revised 1965 SEI exempted shareholders from consolidated income tax if the enterprise re-invests its undistributed earnings for capital increase (Article 13). It permitted accelerated depreciation against business income tax for machinery and equipment acquired for the purpose of increasing the enterprise's productive or service capacity (Article 12). The revised law also exempted import duties on machinery or equipment not domestically available, which is imported by productive enterprises especially for the purpose of research, development, experiment or quality inspection (Article 21(III)). At the same time, however, Article 15 of 1965 SEI raised the maximum tax rate of business income tax to 25 per cent of an enterprise's total annual income. This maximum rate was revised up from 18 per cent in 1960, but in the revised law was limited to 22 per cent for those enterprises satisfying the needs for development of economic and national defence industries which were capital-intensive and/or technology-intensive. The differentiation in the maximum tax rate was intended to encourage investment on key industries: it may, however, be doubted whether a 3 per cent difference would have had much incentive effect, especially since the net rate was still higher than that in 1960. Non-resident alien and foreign business enterprises' withholding tax was also increased from 10 to 15 per cent (Article 16). The tax rate was revised up with an eye for encouraging foreign investors to settle in Taiwan.

Apart from the above-mentioned amendments, one important addition to the 1965 SEI was legislation authorising the Government to transfer public-owned enterprises to private ownership and to use the proceeds for the establishment of a development fund (chapter IV of the 1965 SEI). Under these provisions, the Government would be able to generate financial sources to support key industries other than public works. Another important addition was the so-called 'most favourable' clause. It was anticipated that other laws might be inconsistent with the encouragement provisions in the SEI - and even, in some instances, more advantageous to an investor. To prevent possible confusion, and to ensure full legal protection of investors' interests, a proviso was added to the effect that provisions most favourable to the investor shall apply (Article 2).

In 1970, more investment incentives were inserted in the revised SEI. For example, a 15 per cent tax reduction was permitted to a company limited by shares which publicly lists its shares on the stock market (Article 24). A 50 per cent reduction of deeds tax pertaining to property used for productive purposes was also allowed (Article 22), and land value increment tax for productive enterprises was allowed to be paid over five years by instalment (Article 19). Other incentives included an instalment payment and one year deferred payment of customs duties on machinery or equipment imported by productive enterprises for their own use (Article 21(I)); together with deduction of the purchase value of registered stocks or corporate bonds of three or more years' maturity from taxable income for the third year of continuous holding provided that the deduction does not exceed 25 per cent of income for that year and of the remaining balance, if any, in two subsequent years (Article 20). One of the important changes in the 1970 amendments allowed qualified productive enterprises to select either a five-year holiday from income tax or to depreciate fixed assets on the basis of an accelerated service life (Article 6). The amended SEI provided more tax benefits to specified productive enterprises and individuals. CIECD continued to modify and improve the investment climate

as the situation demanded. The SEI was revised more than a dozen times by 1980 (Gold, 1990: 78).

6.2.2 The Revision of the Statute for Investment by Foreign Nationals and of Statute for Investment by Overseas Chinese

The Government also revised the SIFN (twice) and the SIOC in 1968. The 1968 amendment of both laws was meant to remove the restrictions on domicile and on Chinese nationality for overseas investors in Taiwan. Article 18 of the 1968 SIOC and SIFN stipulated that where an invested enterprise was organised as a company according to the Company Law,²⁶ its investors may be exempt from the restrictions concerning domicile in Chinese territory and Chinese nationality contained in Article 98(I)(II), 128 (I)(II), 208 (V) and 216 (I)(II). The above articles in the Company Law required that at least half of the shareholders of a company (Article 98 and 128), and its chairman and vice chairman (Article 208), must be ROC nationals domiciled within the territory of the ROC. At least half of the executive directors (Article 208) and at least one of the elected supervisors (Article 216) should also be domiciled within the ROC. The exemption offered 100 per cent ownership to overseas investors and removed an important impediment to foreign corporate investment in Taiwan.

In addition to reforming these legal regimes during the 1960s, the Government also revised other relevant laws to ensure consistency with the SEI, SIOC and SIFN. Thus, most importantly, the Government not only reduced the legal obstacles to investment but also improved co-ordination between the various responsible agencies, and simplified procedural matters relating to investment applications. For example, prospective investors had been required to submit 36 copies of applications and had to spend 3 months going through various

²⁶ The Company Law was promulgated on December 26, 1929, effective from July 1, 1931. Amended on April 12, 1946, July 19, 1966, March 25, 1968, September 11, 1969, September 4, 1970, May 9, 1980, December 7, 1989, and November 10, 1990.

bureaucratic procedures (Hsing, 1971: 221). Time was lost because there was no independent government agent in charge of investment applications. All applications had to be approved by different agents, such as the Ministry of Finance (MOF), Ministry of Communications, etc. In order to simplify the administrative procedure, the Investment Commission, under the MOEA, was established in 1968 to screen and handle all investments made by foreign nationals and overseas Chinese (Wu, 1993: 31). After administrative simplification, investors only had to file 3 copies of applications, and the time required for final government decisions on investment applications was reduced to less than a month (Hsing, 1971: 221).

Even with what were, for the 1960s, relatively pioneering liberal foreign investment codes and simplified application procedures, Taiwan clearly had an uphill struggle in trying to attract foreign capital (Long, 1991: 84). Taiwan could offer no outstanding natural resources base, no sizeable domestic market, no long-term guarantee of political stability. What Taiwan did have by that time was a capable, educated and cheap workforce, a relatively developed infrastructure, and a US aid-sponsored investment marketing strategy of some sophistication.²⁷ Even so, foreign investor response was slow.²⁸ To make Taiwan more attractive to foreign

²⁷ Once more, the US provided important help to the ROC Government regarding how to attract FDI. AID addressed these concerns prior to the end of the AID mission. It publicised Taiwan as an investment site, and the US government utilised several programmes to facilitate and protect the flow of private capital to Taiwan and other LDCs. These included the AID Investment Guarantee Programme, Cooley Fund, China Trade Act, and Sino-American Industrial Guarantee Agreement. For more information about these programmes, see Schreiber (1970).

²⁸ Although tax incentives undoubtedly helped to create a more favourable investment environment in Taiwan, other factors, particularly political stability, were also important to foreign investors. In fact, as was made clear by the survey conducted by the Tax Reform Commission in 1968, the importance of all tax concessions taken together for the encouragement of foreign investment (both by Overseas Chinese and foreign nationals) compares rather unfavourably with such considerations as political stability (cited by 1,201 respondents), low wage rates (849), an attractive domestic market (701), well-educated and dependable labourers (625), low cost energy fuel (577), contrast the assurance of a five-year tax holiday (551), and other tax incentives (202) (Executive Yuan, Tax Reform Commission, 1970: 100). Given the fact that tax savings in Taiwan were often partially negated by increases in tax paid to the foreign investor's own country and that tax exemption occurred during the initial period of operation, when profits tend to be slow, it is not surprising that foreign investors attached relatively little importance to tax incentives (Hsing, 1971: 220; Ho, 1978: 239).

investors, a further investment promotion scheme was launched and the Statute for the Establishment and Management of Export Processing Zones was enacted in 1965. In 1966 the first export processing zone was established in the southern port city of Kaohsiung. This offered complete duty exemption and other tax incentives for export businesses set up in the Zone (Long, 1991: 84).

6.3 Export Processing Zones

Export Processing Zones (EPZs) were another important step taken by the Government to solicit FDI and further integrate Taiwan's economy with the global one. The Government established EPZs in Kaohsiung (KEPZ) in 1966, Nantze (NEPZ) in 1969 and Taichung (TEPZ) in 1971 (Lim and Fong, 1991: 65; San, 1989; Gold, 1990: 86). It is useful to consider EPZs in some details, since the establishment of EPZs and bonded factories in the 1960s attracted considerable quantities of FDI into Taiwan, helped to maintain a relatively strong international position for Taiwan's exports, and has subsequently been praised by most economists.

The EPZs were, and still are, located in the port cities, with more mobile bonded factories spread throughout the island²⁹ (Ho, 1978: 197). They were created by the Government in order to serve the four following purposes: (1) attracting industrial investment from overseas Chinese and foreign nationals, (2) expanding the export trade, (3) creating job opportunities, and (4) introducing up-to-date technology (KEPZ, 1968). One advantage to investors is the availability of specially-designed and largely self-contained industrial estates with factories and

²⁹ It is interesting to note that the Japanese seemed to have a preference for EPZ investments, the United States for bonded factories. In 1980, for example, more than 60 per cent of total US FDI exports emanated from bonded factories, compared to 25 per cent for the Japanese. With respect to EPZ exports, the figures were reversed; 5 per cent for the US and 31 per cent for the Japanese (Ranis and Schive, 1985: 97).

utilities installed, local labour easily available, and nearby access to ports and airports (Woronoff, 1992: 78). Another attraction is the availability of various fiscal and investment incentives (Ranis and Schive, 1985: 94). One of these incentives is efficiency. Official transactions, from investment application to foreign exchange settlement, are handled by one centralised agency, the Export Processing Zone Administration Bureau, which enjoys decision-making power beyond the red tape of the ministries (Gold: 1990: 80).

Firms in EPZs enjoy all privileges and tax incentives provided to export producers in Taiwan. In addition to giving investors the advantages of nonunionised, cheap labour, and the incentives already contained in the ordinary foreign investment statutes, locating in an EPZ entitles an investor to (1) exemption from import duties and related levies, commodity tax and business tax; (2) freedom from quantitative control of exports and imports; (3) virtually complete freedom from exchange control where the foreign exchange needed to procure equipment and new materials was self-provided; (4) free remission of business profits and capital; and (5) provision of standard factory buildings by the EPZ administration for immediate occupation with a 70 per cent loan to be paid back on a 10-year instalment basis (Huang, 1986: 207; KEPZ, 1968; Hsing, 1971: 215). EPZs thus facilitate the routine importing of raw materials, the adding of value (mainly in the form of unskilled labour), and the re-export of the more fully processed or finished goods, very often taking advantage of U.S. tariff code provisions 806 and 807³⁰ (Yoffie, 1993: 201). The regime also facilitates the Government's desired economic shift to a new mode of export-oriented manufacturing production, based in particular on imported raw materials (Ranis and Schive, 1985: 94).

³⁰ Items 806.30 and 807.00 of the US Tariff Schedules (as amended in 1963) allowed the duty-free entry of US components sent abroad for assembly or re-processing, then re-exported back to the United States; only the value added by foreign labour was subject to tariffs (19 U.S.C. s 1202). These items were replaced by Subheadings 9802.00.60 or 9802.00.80 of the Harmonised Tariff Schedule of the United States in 1988 (Pub. L 100-418, Title 1, s 1204(a) August 23, 1988, 102 Stat. 148).

Because customs duties, commodity tax, and sales tax are not levied at all, the investors bypass the bureaucratic procedures involved with tax rebates. However, only firms in approved industries³¹ and those willing to meet certain other conditions are allowed to operate in EPZs.³² For example, the industries permitted to operate in KEPZ are limited to those which are not competing with export industries which have been developed domestically, nor having to face a saturated world market, and whose products contain services amounting to no less than 20 per cent of their total value (Hsing, 1971: 232; KEPZ, 1968).

Notwithstanding a slow start, the EPZs have become a major force in the economy (Wang, 1980: 7-28). With as many as 80,000 workers and more than US\$ 2 billion of exports annually, these zones were and remain a great boon to the economy (Woronoff, 1992: 79). The Investment Commission of the MOEA approved 29 applicants in 1961, 103 in 1966, 212 in 1967, 321 in 1968, and 201 in 1969 (TSDB, 1997: 242). At the end of 1973, 290 factories were located in the three zones, of which 222 were in operation (*EPZ Concentrates*, 1980, vol. 5, no. 7-8: 59). The combined investment of these firms exceeded US\$ 148 million (*FCW*, 1974: 1). Local capital, singly or in partnership with foreigners, has also invested actively in EPZs (Gold, 1990: 80). By the end of 1984, aggregate committed investment in the three zones came to US\$ 417.5 million, and the EPZs enjoyed a surplus of nearly US\$ 1 billion in foreign trade (Huang, 1986: 208-209; Tuan, 1992: 126-127). Exports from the zones increased from US\$ 8 million in 1967 to US\$ 405 million, or about 9 per cent of Taiwan's total exports in 1973 (Ho, 1978: 197-198). FDI in the EPZs grew substantially between the mid-1960s and 1980 (Schive, 1994: 416-417). Although FDI in the EPZs is in the vicinity of 20 to 25

³¹ In the late 1960s and early 1970s, precision, labour-using, and relatively high value-added industries (e.g., precision machinery, electronics, optical equipment, and plastic products) were given priority for admission to the zones (Ho, 1978: 197).

³² For details of the regulations, see EPZ Laws and Regulations (1965), KEPZ *Answers* (1970), NEPZ *Answers* (1971).

per cent of total arrived FDI, more than 80 per cent of the capital in EPZs is from overseas (EPZ Essential Statistics). These statistics show that EPZs achieve the first three purposes. The only thing that EPZs did not do adequately is to upgrade skills, since most of the output was of simple, labour-intensive products. Consequently, in 1980, a novel version was unveiled at Hsinchu Science-based Industrial Park (see Chapter 7.3 below), which attracted high-tech industries due to the availability of trained technicians and engineers and the proximity of technical schools and institutes (Woronoff, 1992: 79).

6.4 FDI during the Primary Export-Substitution Phase

In a relatively small country like Taiwan one would expect FDI to become significant only in the course of the primary export-substitution phase of the 1960s. As table 5.2 indicates, this was proved to be the case. In the primary import-substitution phase, FDI tends to be motivated by a desire for access to the domestic markets of large countries. The function of FDI during a primary export-substitution phase becomes increasingly important: FDI can not only provide information and access international markets, but it can also supply the foreign technology needed to help the industrial sector to achieve and maintain a competitive position in international markets (Ranis and Schive, 1985: 92).

In the initial export-substitution period in Taiwan, FDI inflow was mostly of the 'sourcing' kind, focused on taking advantage of the large volume of cheap labour being released by agriculture. FDI provided an important augmentation of the domestic savings fund, as well as additional management, technology, and entrepreneurial capacity, essentially as add-ons to the domestic industrial structure (Chan and Clark, 1992: 85; Ranis and Schive, 1985: 93). Most of the FDI in this period was in labour-intensive, export-oriented light industries such as textiles, and in electronic assembly processes based on value-added concepts. This type of

industry operated under free trade conditions in Export Processing Zones (EPZs) and bonded factories, without requiring the dismantling of protection for locally owned import-substituting industries (Lim and Fong, 1991: 64).

Taiwan was a battleground for intense international competition between US and Japanese industry. In 1964 the US firm, General Instruments, became the first major company to establish a bonded factory in Taiwan (Long, 1991: 84). Its immediate success demonstrated the potential of offshore assembly in Taiwan to other US firms.³³ As US firms gained competitive advantages through a low-cost assembly operation in Taiwan,³⁴ their international competitors felt compelled to follow suit (Wornoff, 1992: 72). Japanese firms then began to invest in Taiwan, in order to lower labour costs and to re-capture US market share, spurred also by the fact that US import quotas had been placed on direct Japanese imports.³⁵ Taiwan thus “became vital to the global production structures of corporations from two different core economies” (Gold, 1990: 79).

American investors on Taiwan were generally large MNEs, which set up wholly-owned subsidiaries to cut costs on goods targeted at the US market. The

³³ Seven more US firms invested in Taiwan in 1964, with a further seventeen in 1965 (TSDB, 1997: 244). They set up bonded export factories throughout the island as well as plants in EPZs (Gold, 1990: 83).

³⁴ Many US firms relocated their assembly operations to Taiwan and other third world countries to reduce production costs and offset the flood of cheap Japanese imports, particularly in electronics, to the US market (Bello and Rosenfeld, 1990: 245). There were two main incentives: cheap labour, and items 806.30 and 807.00 of the US tariff code (see chapter 6.3). By the late 1960s, “roughly half of US imports came in under tariff item 807, most of them from the factories of US firms in Mexico and Taiwan” (Grunwald and Flamm, 1985: 69-70; Oman, 1989: chapter 5).

³⁵ As Americans imposed quotas on Japanese imports, the Japanese began to assemble parts in Taiwan for shipment to the United States, at least until Taiwan fell under similar restrictions (Yoffie, 1983: 113-116; Gold, 1990: 80). Apart from the reasons mentioned in the text, the Japanese also invested abroad because of domestic problems which occurred in the early 1970s. Labour shortages, high wages, lack of land and pollution led the Ministry of International Trade and Investment (MITI) to urge certain enterprises to invest abroad. Labour-intensive, technologically simple smaller firms migrated, so that Japan itself could concentrate on high technology, i.e., capital- and knowledge-intensive, high quality, high value-added goods (Johnson, 1982 chapter 8; Ozawa, 1979; Gold, 1988a: 196).

MNEs were willing to obtain parts locally rather than import them, if they met specifications. By contrast, Japanese investors tended to comprise small and medium-sized companies. To the extent that they invested, the big firms, often through joint ventures and licensing agreements, sought to penetrate Taiwan's domestic market in addition to that of the US and other countries (Gold, 1990: 80). The smaller Japanese firms also frequently took local partners. But, whether large or small, Japanese companies were loath to purchase locally made goods and continued to import parts from Japan.³⁶ Taiwan thus became a "repository for industrial sectors [products] no longer viable for the US or Japan" (Gold, 1990: 81). It entered the emerging international division of labour at the bottom end of the product life cycle.³⁷

Apart from American and Japanese investment, overseas Chinese, primarily from Hong Kong and Southeast Asia, comprised the third major category of foreign investor in Taiwan³⁸ (Schive, 1991: 417-419). Coming from countries less

³⁶ In Japan's view, their joint ventures, in which they commonly held a minority share, functioned as captive markets for Japanese-made parts which were then assembled into goods for sale under Japanese brand names within Taiwan's tariff walls. Joint-venture contracts stipulated the purchase of Japanese parts and restricted the markets for finished goods. Japanese found numerous means to evade local-content requirements. The government took action on many complaints by local industrialists on tariffs and taxes, but it, fundamentally, failed to redress the local-content problem in anything more than a sporadic and ad hoc fashion. (Gold, 1990: 83).

³⁷ The product life cycle is a concept popularised in the US through the work of Raymond (1971). It envisages that products go through stages of origin, development, and decline, each of which has different requirements of technology, investment, skilled labour, etc. Japan's rapid postwar development has been characterised by careful analysis of the product life cycle by Japan's economists, who break the production process into stages and determine where production of which products is most cost-effective. As is noted above, in the mid-1970s, MITI decided that Japan could no longer make certain goods competitively, and encouraged and assisted Japanese manufacturers to shift production of those items offshore - first to Taiwan and South Korea - and to concentrate instead on developing new products. That is, Japan would stay at the origin stage of the product life cycle and let newly industrialising countries such as Taiwan and Korea take over when Japan lost competitiveness. This concept is also at the root of popular discussions of a new international division of labour based on a nation's comparative advantage at producing particular goods at different stages of the cycle. For details, see Fröbel, Heinrichs, and Kreye (1980); Ruggie (1983); Kurth (1979: 1-34).

³⁸ In the 1960s, overseas Chinese investment in Taiwan came mainly from Hong Kong (40.8%), the Philippines (31.8%), Malaysia (12.2%), Japan (7.6%), US (3.4%) and Thailand (2.9%) (MOEA, Statistics on Overseas Chinese and Foreign Investment, 1996).

developed than Taiwan, they invested in textiles, competed with the exports of Taiwan's local capitalists, and in other import-substituting light industries, which transfer little technology (Wu, 1993: 10). Their main contribution was political - "demonstrating with their capital the conviction that the ROC was the legitimate government of China" (Gold, 1983: 267-278). When Taiwan began to market itself overseas in order to boost exports, overseas Chinese in Southeast Asia provided the network that Taiwan first turned to. This alerted many to Taiwan's comparative advantages, particularly its privileged relationship with the US, and continued flow of aid-financed imports (Long, 1991: 85).

The results of Taiwan's strategy to attract FDI were impressive. As mentioned in Chapter 5.2.3, not only did the number of cases of approved foreign investment increase, but also the total annual amount of foreign investment jumped from US\$ 15 million in 1960 to US\$ 162 million in 1971 (Ni, 1987: 260; TSDB, 1997: 242). FDI grew rapidly during Taiwan's transformation period. In the years 1965-1970 alone, the total amount of FDI inflow exceeded that for the 1952-1964 period by fivefold (Investment Commission, 1996: 5; Myres, 1990: 49). Between 1961 and 1972, there were in total 1,533 approved investment cases amounting to US\$ 815 millions. Of these, 57 per cent by number (but only 27 per cent by value) were by overseas Chinese. 178 investments, making up 37 per cent of the total value, were by US investors. Japanese investors made 419 separate investments, accounting for 13 per cent of the total value (TSDB, 1997: 242-244). Among foreign investors, American were clearly dominant in terms of investment value.

FDI was attracted to Taiwan not only by the mixture of a liberal investment climate with an authoritarian political framework³⁹ - which helped ensure a docile

³⁹ While the government adopted a more open policy towards industrialisation and investment, and the country as a whole benefited from economic growth, there was no comparable simultaneous political relaxation, and political development lagged behind. This was another distinguishing characteristic of Taiwan's development: the bifurcation of the economy from the polity. Under the umbrella of 1934 Martial Law, the Government employed repressive measures against any 'rebellion'. Mendel (1970: 112-121) has described several political cases,

labour force - but also by a number of favourable international developments in the mid-1960s, which occurred as the relaxation of cold war tensions facilitated a general expansion of world trade.

First, the Cultural Revolution (1966-1976) in mainland China finished off any hopes of a reconciliation between Peking and Washington (Klein, 1992: 260). It also slammed shut the economic door to mainland China, which sealed itself off in ten years of economic isolation. It also strengthened Taiwan's support abroad (Gold, 1990: 86).

Secondly, the escalating Vietnam War (1964-1972) further poisoned relations between the US and mainland China, firmed up America's commitment to contain communism, and forced the US to take a more active interest in the region.⁴⁰ Like Thailand and Singapore, Taiwan profited from US investment in military support (Long, 1991: 85). Just as the Korean War provided a much needed stimulus to the moribund Japanese economy of the early 1950s, Taiwan, as well as South Korea, eagerly seized the business opportunities provided by massive US spending related to the Vietnam War (Chan and Clark, 1992: 100). Taiwan's economy was boosted by US military purchases of agricultural and industrial commodities,⁴¹ designation of Taiwan as a destination for rest and recreation, and by contract work for and in Vietnam (Bello and Rosenfeld, 1990: 178).

Thirdly, Taiwan's aggressive and well thought-out marketing strategy towards foreign investors came at a time when many potential competitors were adopting less friendly stances. The tide of economic nationalism was running

such as P'eng Ming-min case, from the 1960s. See also Kerr (1965: 446-448); Jacobs (1971: 143-149); Peng (1972); Ong (1979: 183-185); and Shih (1980: 1126-1142). For the Government's position, see China Yearbook (1961-1962: 16-18).

⁴⁰ An exemplary analysis of the interaction of the cold war and economics in Northeast Asia is in Cumings (1984).

⁴¹ Because the US did not classify Taiwan as one of the 19 financially strong nations, South Vietnam was allowed to procure US-aid-financed imports from Taiwan (Ho, 1978: 198).

especially high in some Latin American countries, which in terms of labour cost alone should have been well-placed to attract large amounts of export-oriented overseas investment (Long, 1991: 85). As countries began to reconsider the place of MNEs in their economies, devising strategies to regulate them, Taiwan appeared on the scene - its officials aggressively offering allowances of 100 per cent ownership, guarantees against nationalisation, tax holidays, low wages, and the prospect of no strikes⁴² (Gold, 1990: 87).

Finally, perhaps the centrepiece of Taiwan's new investment environment, created by the post-1958 reforms, was its comparative regional advantage in offering very cheap, abundant, disciplined, and educated labour. For example, in 1972, skilled labour in Taiwan earned an average US\$ 72 per month, which was only 70 per cent that of South Korea, 57 per cent that of Hong Kong, 38 per cent that of Singapore, and only 26 per cent that of Japan. For unskilled labour, the respective rates were US\$ 45, US\$ 60, US\$ 68, US\$ 82, and US\$ 120 (Arthur D. Little, 1973b: 10-11). At the same time, Taiwan's labour efficiency was ranked just below that of Japan and the United States (Arthur D. Little, 1973a: 55).

The policy changes of the early 1960s stimulated local entrepreneurs into exporting. They entered growth fields such as electronics, aggressively seeking Japanese or US partners (Gold, 1988a: 185). The large-scale assembly and manufacturing enterprises set up by US and Japanese investors also encouraged the development of small-scale local operations to supply them.⁴³ Such Taiwanese

⁴² Before the 1934 Martial Law (see chapter 4) was annulled in 1986, strikes were not allowed in Taiwan.

⁴³ There were an estimated 260,000 business enterprises in Taiwan in 1988, of which 98 per cent were considered small business (McGregor, 1989: 2; Lee, 1989: 26). These formed the backbone of Taiwan's trading economy, accounting for 65 per cent of exports (Chin, 1988: 61). Small- and medium-scale export-oriented manufacturing entities were a predominant feature (having paid-up capital not exceeding NT\$ 20 million, assets valued at less than NT\$ 60 million, or less than 300 employees: CEPD, 1980: 14) of Taiwan's economy. In part this can be attributed to the congruence of Chinese cultural traditions: everyone with a modicum of capital wanted to be chairman of his own company. It was also in part a consequence of the type of investment sought by the Government - MNEs would generate a market for a host of

companies as Tatung and Sampo emerged in the 1960s based on various forms of cooperation with foreign interests (Hsin-ching Publishing Co, 1982; Lai, 1983).

During this period, the growth of industrial exports in the 1960s averaged 36 per cent a year. Particularly strong growth was registered in three major export categories: textiles, leather, and wood products (Ho, 1978: 200). The composition and destination of Taiwan's exports also changed dramatically over that period. As a percentage of total exports, industrial products rose from 32 per cent in 1960 to 79 (83) per cent in 1970 (1972) (TSDB, 1997: 192). Textile products became the most important export, and increasing their share of total exports from 14 per cent in 1960 to 32 per cent in 1970. By the end of the decade sugar contributed only 3 per cent of the total exports and rice exports were almost negligible⁴⁴ (Chou, 1973: 95). The composition of exports shifted from a primary agricultural to non-agricultural origin, and the increased diversification in export suggests that not only had Taiwan acquired the valuable capacity of export substitution, but also that the export-led policy was leading Taiwan to industrialisation (Galenson, 1979). At the same time, exports to the US grew as a proportion of the total from 12 to 38 per cent, but exports to Japan dropped from 38 per cent in 1960 to a mere 15 per cent in 1970 (Kuo and Fei, 1985: 54-84; Scott, 1979: 308-383). Conversely, 55.6 per cent of imports came from Japan in 1974, and 29.5 per cent from the US (CEPD, 1980b:

small local suppliers and assembly operations (Long, 1991: 87). This structure of production allowed businessmen to respond very quickly to market demand, and reduced problems of excess capacity, thus promoting internal competitiveness and external flexibility. The strong role of small business, in addition, helped promote the geographic dispersion of industry in Taiwan that in turn facilitated socioeconomic equality by enabling underemployed agricultural workers to seek part-time factory work. For more information about small businesses in Taiwan and their contribution to Taiwan's economic development, see Ho (1980); Fei (1986: 109-124); Greenhalgh (1988: 224-245); Hsiao (1988a: 12-23); Lam, (1988; 1990: 28-34); Li (1986: 77-96); Sutter (1988).

⁴⁴ 1965 was the last year in which agricultural goods would earn more than industrial exports, and by the late 1980s industrial exports would rise to roughly 95 per cent of Taiwan's exports (TSDB, 1997: 213).

24). This reveals an overconcentration of markets and suppliers⁴⁵ and the central role of foreign-owned enterprises (Gold, 1990: 86).

The strong export performance in the 1960s and early 1970s also brought about a significant improvement in Taiwan's balance of payments. Although Taiwan's trade with Japan was consistently in deficit throughout the post-war years, trade with the US shifted from a deficit to a surplus in 1968 and has remained so ever since (Hartland-Thunberg, 1990: 116). The shift in the US position reflected the ending of US aid and Taiwan's transformation from a debtor to a net creditor internationally (MOEA, 1988). Thus, despite the cessation of US economic aid in 1965, Taiwan's improved trade position, plus the influx of foreign investment attracted by the new economic environment, enabled it noticeably to strengthen its international reserves in the following years nonetheless⁴⁶ (CBC, 1975: 9-12; Ho, 1978: 200).

It is worth mentioning that Taiwan's internal investment record was extremely strong in this period, another important reason for Taiwan's rapid industrial transformation. Savings as a proportion of GNP, which had averaged about 9 per cent in the 1950s, skyrocketed from 12 per cent in 1962 to 35 per cent in 1973 - one of the highest in the world (Huang, 1989: 93-121). This permitted the investment rate of GNP to rise to an average 25 per cent in the second half of 1960s, despite the termination of US aid in 1965 which had financed over 40 per cent of Taiwan's investment (Myres, 1984: 500-528). These increased savings were augmented by Taiwan's successful measures to stimulate and manage foreign investment. FDI, which accounted for less than 1 per cent of total investment

⁴⁵ Apart from the US and Japan, Taiwan's trade was spread over a large number of trading partners, with no one country ever achieving a 10 per cent share (Hartland-Thunberg, 1990: 116; TSDB: 1997: 248).

⁴⁶ Foreign asset holdings of Taiwan's banking system increased from NT\$ 17 billion in 1968 to NT\$ 36 billion in 1971 and NT\$ 75 billion in 1974 (CBC, 1975: 9-12).

during the 1950s, had reached 9 per cent at the beginning of the 1970s (Haggard and Cheng, 1987: 84-135).

Unlike the experience of many other developing countries, where foreign capital simply displaces domestic businessmen, MNEs in Taiwan are generally credited with a key role in stimulating the export drive (Gold, 1988a: 184). This was because the Government deliberately harnessed MNEs to the island's developmental objectives (Chan and Clark, 1992: 85-86). While granting wide investment scope to local and foreign investors, reducing red tape and liberalising trade, the Government nonetheless ensured that it retained a determinant role in the economy. It maintained ownership of key upstream productive enterprises as well as of the banking sector (Huang, 1989: 93-121). The state channelled FDI into priority sectors such as electronics and away from others such as textiles to prevent denationalisation. At the same time, it maintained state monopolies in heavy industry, which are often dominated by foreigners in developing countries. Ensuring that most FDI went into export industries also kept the domestic market largely off-limits (Schive, 1990).

Although encouraging trade, the Government still maintained a long list of prohibited and controlled imports. This "created a kind of dual economy in which exports, but only exports, could be manufactured under virtually free trade conditions" (Little, 1979: 475). Taiwan did not develop a *laissez-faire*, free market economy; the Government retained multiple controls and only permitted what seemed like free-market activities within strict bounds (Gold, 1990: 87).

Because the dramatic increase in Taiwan's total industrial output and export boom in the 1960s was due to a combination of diverse internal and international factors, the quantitative contribution of FDI to all this, while substantial, was by no means overwhelming.⁴⁷ The major contribution of FDI has been in the qualitative

⁴⁷ Contribution of FDI to capital formation in the 1960s was only 5.21 per cent (CEPD, 1983).

domain. Its significance was in the advancement of technology, job creation, and the expansion of foreign markets, rather than as a financial source for imports. This is especially because trade deficits were greatly reduced after 1964, due to a rapid increase in exports (Kuo and Fei, 1985: 55). Subsequently, the importance of FDI to Taiwan's economic development came to be in the context of quality.

Finally, Taiwan's withdrawal from the United Nations (UN) in 1971 had affected FDI inflow into Taiwan (Ungar, 1979: 105-121).⁴⁸ Taiwan's continued future as a *de facto* independent entity looked doubtful.⁴⁹ Although the US-ROC Mutual Defence Treaty provided the security and stability essential to attract investment, local businessmen nonetheless began to move capital and assets abroad and emigration increased. Foreign trade and investment dipped. Once again, one may observe the importance of political stability as a consideration affecting

⁴⁸ Communist China emerged from its self-imposed isolation and made tentative forays into the international arena at the beginning of 1970s. Western countries responded by trying to establish diplomatic relations with PRC, which necessitated breaking relations with Taipei. The governing rule, agreed upon by the KMT and CCP, is that there is only one China; Taiwan is an inalienable province. As two parties claim to run the legitimate government of all China, foreign countries can only have full diplomatic relationships with one; the other is a 'bandit regime' (Gold, 1988a: 186; 1990: 94; Hartland-Thunberg, 1990: 114; Ching, 1979: 122-146).

"Restoration of the lawful right of the People's Republic of China in the United Nations" is Agenda item 93 of the Twenty-Sixth Session of the U.N. General Assembly (GR *official records*, 1971, 26th Sess., Annex). The agenda had been constantly discussed from the 1966th to 1977th Plenary Meeting (GR *official records*, 1971, 26th Sess., Verbatim Records of Meeting, vol. 2, A/PV.1963- 1996). By a vote of 76 to 35, with 17 abstentions, the General Assembly adopted the draft resolution A/L.630 and Add. 1 and 2. In the face of an international political environment increasingly detrimental to the KMT, the ROC withdrew from the United Nations just before a vote by the General Assembly to give the China seat to the PRC (United Nations, General Assembly Official Records, 26 Session, 1976th Plenary Meeting, 25 October 1971, pp. 18, 33-35). As a result of Resolution 2758 (XXVI) Taiwan was no longer recognised as the legitimate government of China and all the organisations related to it on 25 October 1971. See GA *official records*, 1971, 26th Sess., supplement No. 29 (A/8429); *U.N. Multilateral Treaties Deposited with the Secretary-General* (U.N. Doc. ST/LEG/SER.E/12, 1994: 3).

⁴⁹ 27 years after its withdrawal from the UN, the *de jure* status of Taiwan is still problematic. Its complexity is due not only to ambiguities in international law, but also to conflicts in the interests of international Powers. Even more importantly, the problem is rooted in the baggage of Chinese history and ideology. There has been enormous research, nationally and internationally, on this topic, but the positions of the KMT and CCP seem to be entrenched.

investment decisions (see Chapter 6.2.2 above), evidenced by the fall in amounts of approved FDI from 163 million in 1971 to 127 million in 1972 (see table 5.1).

6.5 Conclusion

By turning to exports and allowing market forces to play a greater role in the allocation of resources, Taiwan was able to develop its economy more in tune with its comparative advantage, i.e. along a labour-intensive growth path. Consequently, unlike many other LDCs, Taiwan enjoyed fast growth in both output and employment. No longer constrained by its limited domestic market, Taiwan's manufacturing production expanded rapidly and its industries operated at closer to full capacity. Industrial growth in the 1960s was not only more rapid, it was also more effectient.

Supplementing the favourable consequences of the international political and economic events of the 1960s, the Government's open FDI policy and its financial and economic reforms helped to create a favourable investment environment for investors and enhanced Taiwan's exports. Some have suggested that Taiwan's strong export performance in the primary export-substitution phase was merely the product of a "specific historical period" (Bello and Rosenfeld, 1990: 178). This is probably partially true. However, had the Government not had a positive attitude towards FDI, the economic development of Taiwan would not have achieved such remarkably rapid growth. If Taiwan's government is to be faulted for anything, it is for the caution that characterised its economic reforms. Had it acted with greater speed, the impact of economic reform and decontrol would have been felt substantially sooner, and had it dismantled the controls and limited the distortions brought about by protectionism more effectively, the results of economic reform could have been achieved more efficiently. In turn, if the economic reform had been achieved more efficiently, a more favourable

environment would have been provided for foreign investors; and more FDI would have come to Taiwan. Nonetheless, the caution shown is understandable, since at the time the reforms were implemented in the late 1950s the new policy package was untested in similar environments overseas, and not all fashionable. In that context the reforms, indeed, were bold.

Chapter 7

Law, Policy and FDI during the Secondary Import and Export Substitution Phase, 1973-1983

Because of the rapid expansion of export industries during the 1960s and the continued high growth of the economy, Taiwan's economy had reached a productivity ceiling by the early 1970s and was again confronted with an apparent dead-end in the road which it had chosen to continued rapid growth. The vulnerabilities inherent in the export-substitution strategy all seemed to appear simultaneously: because of the rapid growth of labour-intensive export industries, the demand for labour rose at a high rate, at a time when there was already a shortage of primary-level labour (Sun and Lee, 1985: 61-62); with full employment and a rising standard of living, wages and other costs rose¹ (Gold, 1990: 94); manufacturing industry had grown too fast for Taiwan's infrastructure, such as railroads, highways, harbours, most of which dated from the Japanese era, to support it (Long, 1991: 88-89; Myres, 1990: 51); international trends towards protectionism resulted in Taiwan's trading partners raising protectionist quotas against its exports, especially textiles, footwear, and television sets (Balassa, 1981: 109-126; Yoffie, 1983; Aggarwal and Haggard, 1983: 249-312); and other developing countries, such as Thailand and Pakistan, with even lower labour costs and more abundant natural resources began to enter the market, while Taiwan's technological edge over its competitors was still marginal (Gold, 1988a: 186).

Compounding Taiwan's economic impasse, the international outlook was further clouded. With the emergence of the PRC from its self-imposed isolation in the early 1970s and the co-incidence of geopolitical strategies in Washington and

¹ For example, the rapid growth of labour-intensive industries stimulated real wage increases of over 5 per cent a year during the export-substitution period (Greenhalgh, 1988b: 67-100).

Peking, the Nixon administration extended official recognition to the PRC in order to play a 'China card' against the Soviet Union² (Klein, 1992: 260). Following the US's lead, many countries switched their diplomatic recognition from the ROC to the PRC.³ The ROC on Taiwan became increasingly isolated diplomatically. Its dependence on cheap exports to Western countries began to appear politically as well as economically vulnerable.

At this juncture, unless the Government were able to formulate an effective strategy for dealing with these internal and external threats, critical bottlenecks could well impede Taiwan's further economic development. Faced with the need for change, the Government in 1972 adopted a Sixth Four Year Plan, which marked a new direction in policy (Gold, 1990: 94). The export orientation would remain, but Taiwan would develop a new tier of import-substitution industries in areas like petrochemicals, electrical machinery, advanced electronics, precision machine tools, and computer terminals and peripherals. This came to represent the Government's Secondary Import and Export Substitution economic policy, lasting from 1973 to 1983: it involved the production of intermediate inputs as well as final

² The US sought to confine the Soviet expansionism by establishing diplomatic relationships with the PRC and then alienating the PRC from the USSR. US President Richard Nixon visited Peking and issued the Shanghai Communiqué with Chou En-lai in February 1972 (Cooper, 1995: 22). The US and the PRC established formal diplomatic relations in January 1979; Taiwan has had no diplomatic relationship with the US since then. The 1954 US-ROC Mutual Defence Treaty expired on January 1, 1980. Although the Taiwan Relations Act, passed by Congress in March 1979 and signed by President Jimmy Carter on April 10, has since served as the basis for relations between the peoples of the US and Taiwan, the loss of US diplomatic recognition and the ending of the mutual security treaty represented the cutting of an umbilical cord after three decades of support and protection from the US (Bush, 1992: 349; Hartland-Thunberg, 1990: 114-115; Gold, 1990: 99).

³ Towards the end of the 1960s, the ROC was recognised by more than 70 nations as the 'sole legal government of China'. In addition, it held membership in 39 important international government organisations (IGOs), including the UN and most of its affiliated agencies. However, in the two years between 1971 and 1973, 37 countries switched their diplomatic recognition from Taipei to Peking (Kau, 1992: 237-238; Thorbecke, 1979: 204-205; Rowan, 1979: 75). Although, after considerable efforts, the ROC managed to win diplomatic recognition from some small new nations, the total number of countries that maintain official ties with ROC is now only 30 (of which none are countries of importance), and Taiwan is able to keep membership in only 15 IGOs (of which only the Asian Development Bank is considered of some importance) (CDN, May 7, 1997).

assembly, and repositioning the country's industry to emphasise more technologically sophisticated and capital-intensive manufacturing (*World Business Weekly*, May 19, 1980: 5; Lim and Fong, 1991: 64).

7.1 Government Economic Policy

All of these inherent structural problems in Taiwan's internal economic organisation and its international standing came to a head with the first oil crisis of 1973-1974 and the serious recession in the West in 1974-1975 (Long, 1991: 89). The world economy entered an era of structural transformation⁴ and was buffeted on all sides by adverse conditions such as the devaluation of the US dollar and a shortage of food production (Hsieh, 1992: 17; Sun and Lee, 1985: 62). The phenomenon of stagflation (inflation combined with zero growth) in the developed world effectively blocked Taiwan's economic growth in two ways: it attacked the markets for Taiwan's export products, and it made imports much more expensive (Long, 1991: 90). Furthermore, Taiwan's fixed foreign-exchange system exaggerated economic fluctuations (Schive, 1989: 13-27). Real exports, which had grown by 30 per cent a year during 1970-1973, actually fell by 6 per cent a year in 1974-1975 (TSDB, 1997: 189). In 1974, wholesale prices went up 40.6 per cent and consumer prices 47.5 per cent, but fell back to minus 5.1 per cent and 5.2 per cent increases respectively in 1975, and subsequently decreased further until the second oil crisis of 1979-1980 (TSDB, 1997: 165). Savings also fell by 9 per cent a year in 1974-5 (TSDB, 1997: 56), a situation that was exacerbated by a precipitous decline in FDI from 8 per cent to 2.5 per cent of total investment between 1973 and 1975 (Chan and Clark, 1992: 86).

⁴ In particular, in terms of a shift of global wealth, the purchasing power in the OECD countries was transferred to the oil-exporting countries during this period (Long, 1991: 90).

Only at this stage did the Government begin pushing harder for secondary import and export substitution, and deliberately accumulating foreign reserves and know-how in order to enhance the stability and self-sufficiency of the manufacturing cycle. This push was symbolised by the 1973 'Nine Major Construction Projects' (increased to Ten in 1974 and completed in 1979) in infrastructure (highway and airport construction, railroad expansion and electrification, nuclear power plants, port modernisation) and industry (petrochemicals, steel, shipbuilding) (Woronoff, 1992: 69; Yeh, 1979: 8-23; China Yearbook 1980: 211-219). The Government retained control over the former but sought investment by private local and foreign investors in the latter.⁵ The major objective of these projects was to vertically integrate⁶ all of Taiwan's leading export industries, and then upgrade them, increase the quality of products output, and expand into new sectors from this base (Gold, 1988a: 186). These construction projects also opened up the era of petrochemical and heavy industries for Taiwan.⁷

⁵ Originally, the Government intended to have joint state-private enterprises undertaking the industrial projects. But when most of the private investors backed out, China Steel Corporation and China Shipbuilding Corporation became virtually 100 per cent government-owned enterprises (Djang, 1977: 92-93). China Steel was designed to supply domestic customers, but began exporting as well (*FCJ*, July 29, 1984: 4). Although it has not consistently been efficient in international terms (sometimes domestic prices have been higher than those available on international spot market), it still became one of the world's most profitable steel companies (*FEER*, November 26, 1982: 75). The same result happened to China Shipbuilding. Despite the chronic global oversupply of shipbuilding in the late 1970s, Taiwan's shipbuilding industry was undoubtedly competitive in world terms, being kept afloat through a mixture of domestic demand and government subsidy (Long, 1991: 92-93).

⁶ The integration was 'vertical' in that it involved the addition of earlier and latter stages of processing to existing industries.

⁷ Since the supply of raw materials and unfinished goods was mostly controlled by foreign companies in international markets, the activities of these companies greatly affected on the normal manufacturing and selling operations of Taiwan firms. Therefore, the Government concentrated on developing industries which produced heavy chemical raw materials and component parts of products. From 1973 onwards, heavy industries together constituted a larger proportion of total manufacturing than light industries, making the transformation toward heavy chemical industries the most important feature of the decade (Hsieh, 1992: 18). In 1983, heavy and chemical industries generated 57.2 per cent of Taiwan's net domestic product. This figure indicates that while Taiwan's industrial structure was not as good as that of the industrialised countries, it was far more advanced than that of most developing countries (Sun and Lee, 1985: 64-65).

Both were much-needed: the petrochemical industry was targeted for major investment on the eve of the first oil crisis, while the heavy industries which emerged were primarily materials and parts industries, supplying traditional export firms, and the machinery industry providing capital goods (Sun and Lee, 1985: 62). Consequently, during the late 1970s Taiwan's reliance on imports of intermediate products and capital equipment decreased⁸ (Schive, 1992: 103). These projects not only compensated for reductions in exports and private investment and helped Taiwan's economy ride out the first oil crisis,⁹ but also constructed an environment favourable to investment and growth (*The Economist*, January 3, 1981). Thus the economy continued to grow, albeit slowly (Hsieh, 1992: 18; Kuo, 1983: 216-217).

At the same time, putting stability first, the Government responded to inflation by raising the interest rate on one-year savings deposits from 8.75 to 15 per cent between July 1973 and January 1974, and by restricting credit¹⁰ (BOT, TFSM, 1984: 76). This brought a tremendous cashflow into banks and helped to curb inflationary spending (Myres, 1990: 52). The real GNP grew only 1.2 per cent in 1974 and by 4.4 per cent in 1975. However, it had recovered to a high growth rate of 13.5 per cent by 1976 (TSDB, 1997: 27). From then on, Taiwan managed to

⁸ Schive has argued that the secondary import and export substitution policy caused an overall fall in imports, which in turn affected the trading structure of the 1980s and caused the ensuing trade imbalances. For details, see Schive (1989: 13-27).

⁹ For example, by establishing the first nuclear power station, the Government reduced the country's dependence on imported energy. Nuclear power accounted for more than 40 per cent of all power generated by mid-1984 (*FCJ*, December 23, 1984: 1).

¹⁰ Scitovsky (1990: 139-140) has argued that the high deposit and loans rates instituted in Taiwan came close to but did not exceed the equilibrium rate of interest, which explains why raising interest rates raised the level of investment or capital accumulation. He has suggested that raising interest rates is likely to have rendered investment a more efficient and more effective engine of growth. He has also claimed that rationing credit by interest rates rather than through bank managers and government officials is almost certain to raise the average return on the total volume of investment, thereby further accelerating growth. See, however, Anrdt (1982) for an interesting contrary view.

keep inflation within reasonable limits¹¹ while maintaining a 9.6 per cent annual rate of real GNP growth between 1975 and 1981 (Scitovsky, 1990: 171).

In order to counter neoprotectionist quotas based on the volume of goods, primarily textiles, the Government encouraged exporters to produce more upmarket, higher value items which earned more for each unit sold. This was another element in the strategy of upgrading the industrial structure (Gold, 1990: 107).

However, because of the resources required for development of industries such as petrochemicals and base metals, as well as the large increase in living standards, Taiwan's dependence on imported energy increased sharply during this period.¹² When the second oil crisis hit in 1979-1980, Taiwan's economy again suffered a blow from stagflation in the midst of a global recession (Sun and Lee, 1985: 62-63). The economy growth rate declined and did not recover until 1983 (TSDB, 1997: 29).

The Government continuously undertook policy adjustments and carried out reforms in response to the disruptions caused by the oil crises during this period (Balassa and Williamson, 1987: 58-59). In 1976 it first established a money market, and gradually relaxed interest rate controls; the interest rates only rose in 1979-1980 because of world-wide inflation (Myres, 1990: 35). As Taiwan became more dependent upon foreign trade during its economic development, it became increasingly difficult for a single fixed exchange rate to accommodate the rapid changes in value of other foreign currencies; a situation that became more acute

¹¹ From 1973 through 1983, the Government managed to keep its inflation rate down to an average of 11.4 per cent. This was much lower than the average of more than 30 per cent recorded by the other developing countries (The Business Guide to Taiwan, 1980: 7-8; Sun and Lee, 1985: 64).

¹² Although Taiwan's dependence on imported oil decreased after the first nuclear power station came onstream in 1979, Taiwan remained 73 per cent dependent on oil after 1979 (AIT, 1981: 3).

after the mid-1970s. Local and foreign investors encountered very unpredictable costs whenever the value of foreign currencies shifted rapidly. Therefore, in February 1979, the Government changed the fixed foreign exchange rate to a controlled-floating exchange rate system¹³ (Sun and Lee, 1985: 63; Kuo and Fei, 1985: 80-83). This helped to minimise unexpected costs and risks for local and foreign investors, and reduced the impact of international economic fluctuations on the Taiwanese economy.

The Economic Planning Council (EPC) issued a Six-Year Plan for 1976 to 1981, emphasising capital and technology-intensive industries, notably steel and petrochemicals. Domestic economic dislocations and lack of confidence pushed the Government to the forefront as the only actor capable of bringing this plan to fruition (Gold, 1990: 100). Late in 1977, the Government terminated the EPC and established the Council for Economic Planning and Development (CEPD). It re-centralised power, taking responsibility for macro-planning, setting priorities, co-ordination, and evaluation (Gold, 1990: 102). Its members were, and are, cabinet ministers backed by a young and well-trained staff (Wen, 1984: 23). The MOEA's Industrial Development Bureau does detailed sector analysis, planning and plan-implementation. In 1979 the CEPD mapped out a Ten-Year Economic Construction Plan (1980-1989) that identified the machinery, information, electronics, electric machinery, and transportation equipment industries as 'strategic' industries, which it would therefore support with specific business and investment incentives (Sun and Lee, 1985: 63; Gold, 1981: 119-123).

In addition, immediately after the Ten Major Construction Projects were completed in 1979, the Government followed them by initiating a further Twelve Major Construction Projects (increased to Fourteen in 1984), with a total cost of

¹³ This system was intended to allow the Central Bank to buy and sell key currencies, such as the US dollar, in order to allow the exchange rate for the NT\$ to be determined by market forces (Sun and Lee, 1985: 67; Myres, 1990: 51).

US\$ 7 billion (Long, 1991: 92-93; *FCW*, June 21, 1981: 1-2). The new Projects included not only transportation and communications, electrical power, additional nuclear power plants, agriculture, and industry, but also basic construction works in the rural living environment, undertaken in order to further the goal of building a modernised Taiwan (China Yearbook, 1980: 211-219; CEPD, 1980a: 35; Sun and Lee, 1985: 63). There is no doubt that the initiative for these projects was partially influenced by the need to get the economy moving again after the second oil crisis (Woronoff, 1992: 69-70). Through an accelerated programme of infrastructure investment, Taiwan kept total investment up during the second oil crisis. More generally, its economic approach was proving successful. Even in 1980, a year marked by world-wide stagflation and rising protectionism, Taiwan recorded a trade surplus of about US\$ 78 million (MOF, 1984). In the meantime, the inflation rate came down dramatically, from about 21 per cent in 1981 to around 5 per cent by 1982 (Scitovsky, 1990: 172). Also, the Real GNP growth in 1983 was 8.7 per cent, and the trade surplus increased from US\$ 3.3 billion in 1982 to about US\$ 4.8 billion in 1983 (TSDB, 1997: 181). In 1979, the Organisation for Economic Co-operation and Development (OECD) reclassified the ROC as a newly industrialising country (NIC, later NIE¹⁴) (OECD, 1979; OECD, 1980).

In 1983, Taiwan was ranked by the International Monetary Fund (IMF) as the 17th largest trading nation in the world,¹⁵ with exports ranking thirteenth and imports eighteenth (*FCJ*, June 10, 1984: 1). Trade was still 50 per cent concentrated

¹⁴ The concept of 'NICs', which at the time included Taiwan, Korea, Hong Kong, Singapore, Brazil and Mexico, was first advanced by the OECD in 1979. Deference to the PRC's sensitivity concerning the sovereignty status of Taiwan and Hong Kong, and continued rapid industrial development in the four Asian NICs through the 1980s, has since led the expression to be changed to 'newly industrialised economies' (NIEs) without reference to Brazil or Mexico (Oman, 1994: 49).

¹⁵ The export and import (two-way trade) in 1984 accounted for 90.6 per cent of GNP and made Taiwan's economy one of the most dependent on foreign trade in the world (Sun and Lee, 1985: 68).

on Japan and, especially, the United States.¹⁶ In 1983, industrial products accounted for 93.3 per cent of Taiwan's total exports. This was in sharp contrast to the export structure in 1952, when agricultural products made up 91.6 per cent of total exports (TSDB, 1997: 192). The comparison illustrates the extent to which Taiwan had transformed itself from an agricultural to an industrial country. Exports to Japan declined from 52.6 per cent of Taiwan's total exports in 1952 to 9.9 per cent in 1983, whereas Taiwan's exports to the US rose from 3.5 per cent to 45.1 per cent (TSDB, 1997: 201). Meanwhile, imports from the US dropped from 45.7 per cent in 1952 to 22.9 per cent in 1983, whereas imports from Japan diminished slightly from 31.2 per cent in 1952 to 27.5 per cent in 1983 (TSDB, 1997: 199). The growing trade deficit with Japan and surplus with the US has caused a trade imbalance.¹⁷ To fend off protectionist moves against the Taiwanese market, the Government sent several 'Buy American' missions to the United States (beginning in 1978) for agricultural purchases.¹⁸ At the same time, frustrated by the refusal of Japan, its main supplier, to buy Taiwanese, the Government imposed a temporary ban in 1982 on some 1500 consumer goods from Japan¹⁹ (Arnold, 1985: 194-196).

It is also worth mentioning that rapid economic growth did not enlarge the gap between the rich and the poor in Taiwan, which is very often a consequence in

¹⁶ Exports to these two countries accounted for 56.1 per cent of Taiwan's total overseas sales in 1952, and remained at 55 per cent even in 1983. Although imports from the US and Japan dropped from 1952's 76.9 per cent to 1983's 50.4 per cent, they still constituted more than a half of Taiwan's total imports (TSDB, 1997: 199).

¹⁷ In Sun and Lee's research (1985: 71-72), they found that there were a number of economic factors which had contributed to the trade imbalance. First, Japanese capital goods and raw materials were much more competitive in the Taiwan market than their US counterparts. Secondly, the US was not only the largest market in the world, but the one which had the least import restrictions. Thirdly, the products Taiwan sells in the US were ones which provided that country with relative advantages and thus enjoyed wide acceptance.

¹⁸ Because of the continued growth in bilateral trade, Taiwan in 1984 was the 6th largest trading partner of the US - the 5th largest supplier and 11th largest export market (Sun and Lee, 1985: 72-73).

¹⁹ Not surprisingly, this fuelled a black market in highly desired Japanese consumer goods, such as VCRs (*The Economic News*, June 7-13, 1982: 1)

other countries.²⁰ The ratio of the average family income of the richest 20 per cent of families to that of the poorest 20 per cent fell rapidly during the 1950s because of the land reform programme, and continued to decline from 5.33 in 1964 to 4.49 in 1972. In 1983 this figure had dropped to 4.36²¹ (Greenhalgh, 1988b: 72; Fei, Ranis and Kuo, 1972: 55, 92-93). Per capita GNP rose from US\$ 196 in 1952 to US\$ 3,100 in 1984 (TSDB, 1997: 32). Obviously, the distribution of incomes in Taiwan was becoming more even and the economic growth had a role in improving living standards as well as reducing socio-economic inequality (Chan and Clark, 1992: 80). This bears out the success of the equalisation of wealth policy of *Min-sheng* Philosophy, and it is a successful example of the ability to stress both wealth and equality that is so rarely seen in the history of the world's economic development.

7.2 Government Policy on FDI and FDI Law Reform

7.2.1 Government Policy on FDI

Secondary import and export substitution policies were targeted at more capital-, skilled labour-, and ultimately, technology-intensive manufacturing industries (Ranis and Schive, 1985: 93). Under this approach, the Government planned to slough off industries that were becoming uncompetitive internationally (such as low-end textiles, electronics, and footwear), and to direct local and foreign investment into strategic industries such as microelectronics and capital equipment

²⁰ In a classic article, Kuznets (1955: 1-28) has argued that income inequality follows an inverse U-curve in developing countries, increasing as the economy grew and levelling off and then declining only much later.

²¹ From a comparative perspective, what is most noteworthy about Taiwan is that the level of inequality is exceptionally low by the standards of both developing and developed countries. Of forty-five countries for which income distribution data were available in 1986, only two had ratios of the top to bottom fifth of households that were lower than Taiwan's ratio of 4.5 in 1985. And in these countries, Japan and the Netherlands, that ratio was 4.4 or 4.3, only a fraction lower than Taiwan's (World Bank, 1986: 226-227). For more detailed discussions on income distribution in Taiwan, see Fei, Ranis, and Kuo (1979); Ke (1983); Ranis (1978: 397-409); and Wu (1978: 67-111).

(Gold, 1988a: 186-197). The first manifestation of its plans took shape in a new high-technology industrial park, located in Hsinchu, which was established as a locus for local and foreign ventures in integrated circuits, PC products, biotechnology, and other cutting edge sectors (see Chapter 7.3 below).

As mentioned in the previous section, the Government invested heavily in infrastructure and hoped to attract investment from local and foreign sources into industry, especially in petrochemicals. The justification was both microeconomic and macroeconomic. From a microeconomic point of view, some large local investors, producers of synthetic fibres and plastics in particular, needed foreign technical and capital participation in order to vertically integrate their operations with the petrochemical industry. Similarly, MNEs were eager to sell their know-how and capture a share of Taiwan's huge indirect export market to third countries in synthetic fibres and plastics (Gold, 1988a: 186). From a macroeconomic point of view, development of the petrochemical industry and a move to locate domestically as many stages of the production process as possible can reduce vulnerability to price fluctuations in imported supplies (Gold, 1990: 101).

During the secondary import- and export-substitution period, the US and Japan were still the two most important sources of FDI (TSDB, 1997: 244). However, the Government would have preferred that the Japanese had concentrated their investments on export enterprises without also seeking to gain a foothold in the local market (Huang, 1986: 224-225). Indeed, the Government consciously excluded Japanese investors from the petrochemical industry, because of fears that the Japanese had already penetrated too deeply into Taiwan's economy. American investors like Mobil, Gulf, National Distillers and Chemical Corporation, and Union Carbide, however, were encouraged to participate in the development of the industry (Bello and Rosenfeld, 1990:247; Gold, 1990: 101).

The Government, together with local interests and foreign investors, set up tripartite style joint ventures in the petrochemicals industry. Because local interests in Taiwan retained a majority or whole ownership of the investment project, these are labelled 'new forms of investment' by investment scholars: unlike traditional FDI, the FDI share in these ventures did not constitute ownership or control of the enterprise²² (Oman, 1989: 7-10). These kinds of joint ventures in Taiwan enjoyed almost the same incentives under the FDI laws as traditional FDI, with the exception of those incentives restricted by a minimum shareholding requirement, such as the privilege against Government expropriation.

Aside from the petrochemical industry, beginning in 1980 the Government also attempted to create a comparative advantage for Taiwan in automobiles. Ideally, this would stimulate the emergence of high-quality parts suppliers (Gold, 1990: 105). But this attempt failed due to conflict among the partners (Gold, 1988a: 186). The Government had negotiated with several Japanese makers to set up a tripartite style joint venture with China Steel and private interests (*FEER*, August 13, 1982: 112-113), and in 1982 a deal was penned with Toyota. After several delays, however, the scheme was abolished in mid-1984, ostensibly due to disagreements over the preconditions that Toyota export half of the cars within eight years, accept a 90 per cent local-content rate, and transfer technology to local partners (*FCJ*, September 16, 1984: 4; *FEER*, 27 September, 1984: 165).

In order to reduce its heavy trade dependence on the United States and Japan, and to diversify the resources of FDI, the Government opened new markets in Western Europe and liberalised imports from that region. In 1979 it abolished the

²² Oman (1984: 12) defined the term 'new forms of investment' as: "(a) joint international business ventures in which foreign-held equity does not exceed 50 per cent; (b) various international contractual arrangements which involve at least an element of investment from the foreign firm's viewpoint but which may involve no equity participation by that firm whatsoever, as is frequently the case with licensing agreements, management, service and production-sharing contracts, and occasionally with sub-contracting and turnkey operations". For a detailed discussion of new forms of investment in developing countries, see Oman (1984) and Oman (1989).

ban on trade with Eastern Europe, except the Soviet Union (*AWSJ*, November 29, 1979: 1). It solicited FDI from European countries and encouraged local corporations to invest abroad in order to guarantee supplies of raw materials and open new overseas markets. The China External Trade Development Council was established in 1970. One of its main aims in the 1970s period was to encourage the formation of large general trading companies to wrest control of trade with Japan from Japanese general trading companies (*sogo shosha*) and American buyers (*Business Asia*, November 17, 1978: 364-365; *FEER*, January 5, 1979: 52-53). Taiwan-Europe trading volumes rose from US\$ 2.1 billion in 1977 to US\$ 5 billion in 1980 (*FEER*, April 4, 1983: 40). Exports to the European economic community (EEC) grew 30 per cent per year from 1975 to 1980 (*Euromoney*, May 1981: 17), and by 1980 the EEC was Taiwan's second largest export market (AIT, 1981: 12). By 1983, Taiwan had become the EEC's twenty-fifth largest trading partner²³ (*FCJ*, December 16, 1984: 4). In the meantime, the total amount of approved FDI in Taiwan from European countries rose almost 7 times from 36 million in 1961-1970 to 225 million in 1971-1980. It took up 10 per cent of the total amount of approved FDI during that period (see table 5.2). One may safely conclude from these statistics that the Government's move to diversify its trading partners met with some success.

To promote foreign and overseas Chinese investment in Taiwan, the Government had continued to simplify its investment procedures. In July 1982, the MOEA set up an Industrial Development and Investment Centre (IDIC), providing a 'one stop' service for foreign investors which eliminated the need to visit various government agencies in order to file a single investment application (Sun and Lee, 1985: 79-80).

²³ This was in spite of the fact that Taiwan was not a member of the GATT and its exports did not qualify for duty-free status under the Generalised System of Preferences, while those of its main-rivals did (Gold, 1990: 110).

Since Taiwan became isolated in terms of international politics, trade and FDI have been the primary mechanisms linking its economy and society to the rest of the world. However, the Communists never renounced the right to use force; nor was the threat of a blockade removed (Gold, 1990: 99). In order to win the loyalty of overseas Chinese and to secure foreign investment, the Government tried to improve its defence capabilities. Although Taiwan was still able to purchase American arms after the 1979 break in diplomatic relations with the US, the quantities available were not thought sufficient by the Government, because the US would only sell Taiwan weapons for defensive purposes under the Taiwan Relations Act.²⁴ New sources of military goods were sought, including Israel and South Africa (*NYT*, April 6, 1977: 1; *FEER*, March 3, 1982: 32-34). Taiwan's defence spending exceeded half of the Government's budget in 1979 (*FEER*, October 27, 1978: 19), and in 1980 rose by 25 per cent from the previous year (AIT, 1981: 2),

7.2.2 The Reform of the FDI Laws

(A) The Revision of Statute for Encouragement of Investment

Between 1973 and 1983, the SEI was revised nine times, the SIFN three times, and the SIOC on four occasions. This reflected the radical change of economic conditions during the period, and the Government's efforts in reviewing and revising its FDI laws in order to cope with the dynamic economic circumstances.

²⁴ Section 3 of the Taiwan Relations Act commits the United States "to make available to Taiwan such defence articles and defence services in such quantity as may be necessary to enable Taiwan to maintain a sufficient self-defence capability" (US Department of State's News Release, 1978; Cooper: 1995: 23-27). However, the quantity of arms the US could continue to sell to Taiwan was specifically limited under the US-PRC Shanghai II Communiqué of August 17, 1982, with the ceiling based upon the 1980 imports figure of US\$ 880 million (*FEER*, January 27, 1983: 28).

The major amendments of the SEI occurred in 1977 and 1980, and I will focus on these reforms.²⁵ In 1977, the Government revised the SEI to offer certain incentives to investors. For example, an enterprise can apply to defer the commencement of the five-year tax exemption by a period of one to four years from the start-up of a business operation, if the enterprise belongs to the category of capital-intensive or technology-intensive productive enterprises (Article 7), or if it is engaged in investment in the exploration, development or processing of natural resources in foreign countries and shipping the products back to Taiwan (Article 8). At the same time, machinery and equipment with special devices to save energy (Article 36) or with special devices for prevention of pollution (Article 47) may be depreciated according to an accelerated service life of two years. The maximum rate of business income tax (25 per cent of an enterprise's annual income) remained unchanged in Article 15 of the 1977 SEI. But, as long as the enterprise engages in basic metal production, petrochemical, or heavy machinery industries and is capital-intensive or technology-intensive in nature, the maximum rate was limited to 12 per cent, revised down from 22 per cent in 1970. Also, business income tax and stamp tax were exempted in respect of contracts for building, inspecting, or repairing ships and aeroplanes navigating on international routes and fishing boats operating in the high seas (Article 32). These incentives were designed to encourage investors to invest in strategic industries, and more generally to explore international resources, to prevent pollution, to reduce the tax burden of productive enterprises, to help the country through the oil crises, and eventually to reorient the nation's industrial structure toward technology-intensive industries. Meanwhile, non-resident alien and foreign business enterprises' withholding tax increased from 15 to 20 per cent. However, if the investments were not approved in accordance

²⁵ Other special enforcement rules promulgated by the Executive Yüan in accordance with the SEI included (1) Categories and Criteria for Special Encouragement of Important Productive Enterprises, in 1981; (2) The Criteria for Encouragement of Establishment or Expansion of Industrial Mining Enterprises in 1981; and (3) Categories and Criteria of Productive Enterprises Eligible for Encouragement, in 1982. The above rules were all annulled on December 31, 1990.

with the SIOC and SIFN, the withholding tax was set at 35 per cent (Article 16). This device provided a big tax-rate disparity between approved FDI and non-approved FDI, with the intention to direct FDI toward preferred industry and to keep FDI under the control of FDI Laws.

Because of the economic recession, the Government sought to stimulate productive enterprise and individual investment by providing tax credits or tax reductions. In Article 10 of the 1980 SEI, the Government allowed businesses to credit 10 to 15 per cent of the amounts invested in production equipment against income tax. If the income tax due was less than the credit amount, businesses were entitled to carry forward the balance to credit against income tax for up to 4 years. The Government also revised the basis for calculation of business income tax, from “not exceeding 25 per cent of the annual total income” to “not exceeding 25 per cent of the annual taxable income” (Article 15). Additionally, where an individual continuously held share certificates for three years after acquisition, up to 15 per cent of the costs of acquisition was permitted to be deducted from his (her) consolidated income tax (Article 20). The effectiveness of the SEI was extended until December 31, 1990 (Article 89). Article 41 of the 1980 SEI also stipulated that a productive enterprise may, within the limit of an amount not exceeding its paid-up capital, retain and not distribute its earnings. This was intended as an incentive for productive enterprises, because an ordinary enterprise is otherwise permitted to retain and not distribute earnings only to the extent of 50 per cent of its paid-up capital. The benefit was augmented in 1982, when strategic industries and important productive enterprises (as designated by the Government) were allowed to retain earnings of up to 200 per cent of their paid-up capital.

(B) The Revision of the Statute for Investment by Foreign Nationals and of Statute for Investment by Overseas Chinese

During this period, accompanying revisions to the SIFN and SIOC were intended to provide a more favourable environment for overseas and foreign investors. Article 12 of the 1979 SIOC, and Article 13 of the 1979 SIFN, for example, stipulated that investors, one year after the commencement of a business operation, could apply for repatriation of capital in any amount up to 15 per cent of the total sum invested. Compared to the 1959 version, the revised laws shortened the repatriation time from two years to one year from the starting date of a business. In the meantime, the amended laws also gave better protection against government expropriation. Article 16 of the 1979 SIFN gave the same guarantee as the 1960 SIFN: an enterprise would not be subject to requisition or expropriation for a period of 20 years after the commencement of business. Moreover, in order to qualify for this protection, the 1979 law required investors to continue to hold only 45 per cent or more of the total capital; the requirement had been 51 per cent in 1960. In order to encourage joint ventures between overseas Chinese and foreign investors, the 1983 amendment added that the above guarantee would also apply to such joint ventures (Article 16 (II)).

Although the statutes provided various incentives to foreign investors, some export obligations were also imposed. Due to the small size of the domestic market, the Investment Commission requested that new foreign factories export half their output and that high-technology joint-ventures should also have concrete plans to export.²⁶ However, foreign-funded firms having overseas shareholdings of less than 20 per cent would be exempted from the minimum 50 per cent export obligation (Wang, 1985: 113; IDIC, 1982).

²⁶ Mandatory export levels for Japanese investors were often set higher, because of their “notorious” reluctance to transfer advanced technology (Huang, 1986: 218).

Apart from the above amendments of FDI laws, the Government also revised the Banking Law in 1975²⁷ to encourage local investment. The Government has monopolised the banking system ever since it moved from the mainland. Because the state banks preferred to fund state enterprises and large private firms, smaller private firms were forced to borrow money from an unorganised kerk market at exorbitant rates (Caldwell, 1976: 736; *AWSJ*, December 4, 1979: 1). To rejuvenate the local capital investment system, the 1975 revision broadened the scope of banking practices. One result was the expansion of investment and trust companies, most of which are part of business groups, such as Cathay, that were otherwise not permitted to merge productive and financial functions. Such companies were able to perform banking functions and to make equity investments (*AWSJ*, January 1, 1980: 1).

7.3 Science-Based Industrial Park

Apart from constantly revising FDI laws to attract more FDI, the Government also sought to involve both local and foreign capital in restructuring Taiwan's economy to increase the international competitiveness of its products. A scheme launched in July 1979 to create a 210-hectare park (now 424 hectares with another 156 hectares under development) only forty-five miles Southwest of Taipei, in Hsinchu, for Chinese and foreign high-technology firms to concentrate talent and resources (Li, 1980: 3; SIPA, 1996: 8). The Statute for the Establishment and Administration of A Science-based Industrial Park (SEAASIP) was promulgated on July 27, 1979, with Enforcement Rules promulgated on June 19, 1981.²⁸ The

²⁷ Promulgated on March 28, 1931 and amended on September 1, 1947, June 16, 1950, November 11, 1968, July 4, 1975, December 29, 1977, July 21, 1978, December 5, 1979, December 5, 1980, July 17, 1981, May 20, 1985 and July 19, 1989.

²⁸ After its initial promulgation, SEAASIP was amended on May 20, 1981 and May 24, 1989. Enforcement Rules were amended on July 1, 1994.

Science-based Industrial Park Administration (SIPA), under the Park Supervisory Committee of the National Science Council, acts as the management institute. All Park enterprises must be incorporated in accordance with ROC Company Law, after their investment projects have been approved by the Park Supervisory Committee (SIPA, 1994: 2).

In December 1980, the Hsinchu Science-based Industrial Park (HSIP, also known as the Silicon Valley of Taiwan) was established, with the main aim of attracting high-tech investment (Bello and Rosenfeld, 1990: 247). HSIP is a bonded, duty-free area with a computerised inventory control system, and aims to create an environment favourable to the development of high-technology industries so as to bring in high-calibre research scientists, while at the same time stimulating domestic research and development (Li, 1980: 3; Chu, 1987: 115). It offers the same incentives as do the Statutes for Encouragement of Investment, including a five-year income tax holiday (Article 15, SEAASIP). In addition, while still offering the advantages of Taiwan's relatively low-cost labour force, it also boasts low-cost engineers, proximity to Taiwan's prestigious technology universities (Tsinghua University and Chiao Tung University), and the availability of the state-run Industrial Technology and Research Institute (ITIR) and its Electronics Research Service Organisation division (ERSO) to develop and make available technology (Gold, 1990: 103; Long, 1991: 94). Meanwhile, for goods and services exported by a Park enterprise, business taxes are computed at a rate of 0 per cent and no commodity taxes are payable (Article 17, SEAASIP). In addition, a science-based industry may obtain low-interest loans for the purchase of equipment or for construction of factory buildings. The maximum period for repayment of such loans is 10 years, including a grace period of one to three years (SIPA, 1994: 5). Further, the Government is willing to take up to a 49 per cent equity share in ventures in the park (Article 23 (II), SEAASIP), replicating the tripartite model used in petrochemicals.

HSIP immediately solicited applications from firms to make minicomputers, integrated circuits, and laser optics. In this way HSIP, like the EPZs described in Chapter 6.3, began to channel new resources and technology into new product lines that are now revolutionising all sectors of Taiwan's manufacturing (Myres, 1990: 50). As of August 1984, the park had fifty-three approved investments, forty of which were already in operation. These included subsidiaries established by important American firms such as Wang Laboratories and Qume (Gold, 1990: 103). Twelve years later (in 1996), there were more than 180 high-tech companies in operation at HSIP with combined sales of US\$ 11.34 billion (*FCJ*, February 14, 1997). Of these companies, 36 were instituted by FDI (including 23 US investors) and 144 were domestically owned. Aggregate investment in HSIP reached US\$ 5.6 billion by 1996. Domestic sources accounted for 88 per cent of HSIP investment capital (of which 8 per cent came from Government investment) (SIPA, 1996: 10-11). Although FDI made up only 12 per cent of HSIP investment capital in 1995, about 23 per cent of current and FDI inflows went to HSIP. This illustrates the success of the Government's efforts to attract FDI in high-tech industries, such as integrated circuits, computer and peripherals telecommunications, optoelectronics, precision machinery and materials, and biotechnology: these are also the major industries in HSIP (SIPA, 1996: 10). In 1996, Taiwan became the biggest notebook computer manufacturing country in the world. 26 per cent of that output was sourced from HSIP (*CDN*, March 24, 1997).

7.4 FDI during the Secondary Import and Export Substitution Phase

As the Government slowly shifted its economic policy from export substitution to secondary import and export substitution with the march of the

international product life cycle,²⁹ two distinct shifts in FDI can be observed. At first, FDI had been directed to exploiting Taiwan's labour supply, which was treated merely as an input into foreign-based manufacturing activities. However, as that resource became more expensive, FDI shifted toward investing in entire proprietary enterprises, whose Taiwan-based activities might supply both domestic and/or export markets. First, FDI shifted from pure sourcing investments to investments which focus on particular proprietary interests with an eye to both domestic and export markets. Secondly, during the late 1970s and early 1980s, capital inflows shifted from FDI to other sources of foreign capital, such as portfolio investment and commercial loans (Ranis and Schive, 1985: 93). It has been demonstrated that FDI and other long term foreign capital has gradually replaced foreign aid (82 per cent in the 1950s) as the main source of capital inflows (CBC: Balance of Payments, 1983). Meanwhile, although FDI still maintained a 22 per cent share of foreign capital inflows in the 1970s, this proportion was by then dwarfed by the influx of portfolio and longer-term capital (78 per cent) (Ibid). "This resulted both from the gradual achievement of economic maturity and from the impact of the oil crisis, which led to petrol-dollar recycling by commercial banks as an increasingly important phenomenon throughout the world" (Ranis and Schive, 1985: 94).

FDI inflow averaged about US\$ 125 million per year during this period (Klein, 1992: 268). However, the amount of arrived FDI was very unstable (see table 5.1). FDI bounced back vigorously after the Nixon shock of 1971 and the oil crises of 1974 and 1979 (TSDB, 1997: 242). One may presume from this that the reluctance of foreign investors derived from the uncertainties of that decade (including the US-PRC rapprochement and the two oil crises). In the two years after diplomatic relations were broken off between the US and Taiwan, overall FDI increased 125.4 per cent, spearheaded as before by American investors (AIT, 1981:

²⁹ see Chapter 6.4 above.

3). Passage of the Taiwan Relations Act through the US Congress in March 1979 (Lasater, 1993: 21), with its implicit American commitment to protect Taiwan, no doubt buttressed foreign willingness to continue investing into Taiwan (Gold, 1990: 110).

As mentioned above (Chapter 7.2.1), FDI and trade became the only two connections between Taiwan and the world after it became almost politically isolated. Nonetheless, the PRC threatened even these connections. It warned American companies that if they continued to do business with Taiwan, they might be prohibited from the mainland, and it made an example of American Express by not accepting its travellers cheques. Some companies, such as Pan Am and First National Bank of Chicago, therefore withdrew their Taiwan operations (Gold, 1990: 98). There is no doubt that the PRC has successfully hindered a great deal of foreign capital from going to Taiwan.

From table 5.2, it should be noted that overseas Chinese investment was very important during this period, and indeed took up 37 per cent of total FDI by value in Taiwan (increased from 29 per cent in the previous decade). Most of the investment went into cement and petrochemical industries because of the need to finance Taiwan's Ten and Twelve Major Construction Projects (Wu, 1993: 9). The US accounted for 25 per cent of the total investment in this period. Compared with 42 per cent in the 1960s, its predominance declined markedly in a decade when the Japanese (17 per cent) and others (21 per cent), mostly European investors (10 per cent), began to play a larger role. (As was mentioned in Chapter 7.2.1, the Government began to encourage capital inflows from European investors in order to help diversify sources of foreign capital.)

Exports by FDI-funded enterprises contributed about 22 per cent of Taiwan's total exports in the 1970s (MOEA, 1981). In general, overseas Chinese investors tended to be less export-oriented than others. This was probably because

overseas Chinese had invested mainly in infrastructure-related industries. US FDI, however, appeared to be more export-oriented than that of Japanese investors, but less than FDI from European investors (Ranis and Schive, 1985: 111). US subsidiaries or joint ventures in Taiwan exported 65 per cent of their total manufacturing product in 1975,³⁰ while the figure for the Japanese was only 53 per cent, and that for European investors almost 96 per cent (Gold, 1988a: 195; Ranis and Schive, 1985: 116). This buttressed the Government's decision to discourage Japanese investors from investing in domestic-oriented industries and thereby exploiting without contributing sufficiently to growth of the Taiwanese economy.

Total FDI between 1970 and 1980 rose by a factor of 700 per cent compared to the total in the previous decade, and comprised 9 per cent of total investment during that decade. While part of the funding went to the new EPZs, overall foreign investment accounted for around 4 per cent of the value added in manufacturing, around 20 per cent of exports, and 10 per cent of manufacturing employment (MOEA, 1981; Ranis and Schive, 1985: 101). The contributions of foreign investment were not only financial, but also extended to better technical know-how and opportunities to import suppliers and increase exports (Kuo, 1975). From these foreign-funded enterprises Taiwanese businesses obtained much valuable technology, via patents, licensing, and technical assistance contracts (Myres, 1990: 55-56).

In April and May 1980, Taiwan was expelled from the World Bank and IMF, but at the same time there was an explosion of foreign bank openings, with the Europeans leading the charge. The thirteen foreign bank offices at the start of

³⁰ Sun and Lee (1985: 80-81) have argued that exports to the US by American-funded companies have been a major contributing factor in Taiwan's long-term trade surplus with the US.

1980 were joined by eight new offices by year's end, five of which were European³¹ (AIT, 1981: 10; Gold, 1990: 110-111).

7.5 Conclusion

In spite of the higher levels of skill and capital intensity required by the new industries of the seventies, in spite of drastic shocks to the world economy from oil price increases, global recession, protectionism, and inflation, and in spite of its isolation from the international community, Taiwan's growth rate continued to be exceptionally high throughout the decade (Klein, 1992: 261-269).

The severe political and economic challenges required increased state intervention after a long period of continuous retrenchment. The Government devised a flexible, multifaceted strategy to reduce Taiwan's vulnerability to the instability of the global economy, primarily by vertically integrating and increasing the self-sufficiency of industry and, to compensate for its diplomatic isolation, by substituting economic ties for political ones (Gold, 1990: 100).

Taiwan's highly successful export-oriented industries underwent a gradual transformation in the 1970s. The textile industry continued to play an important role, but petrochemical and heavy industries gradually increased their importance. Partly this was a response to a deliberate policy of upgrading into more capital- and technology-intensive industries. Partly it reflected a process of vertical integration of existing industries through a second wave of import-substitution capital investment (Long, 1991: 92). Undoubtedly, achieving the goal of vertical integration and self-sufficiency in important industrial inputs has meant that the stability of these industries has never seriously been threatened by uncertainties

³¹ Grindlays Bank of Britain; Banque de Paris et des Pays-Bas and Soci  t   G  n  rale of France (whose parent company is 90 per cent owned by the France government); European Asian Bank; Hollandsche Bank-Unie N. V. of the Netherlands, which is a joint venture of seven European banks (AIT, 1981: 10).

over foreign sources of supply. In the 1980s they achieved efficiency levels comparable with their international rivals (Long, 1991: 93).

During this period of secondary import and export substitution, FDI had a crucial role to play in assisting the industrial sector to maintain a competitive position in international markets despite rising labour costs. FDI was utilised in helping Taiwan's industry to produce high value-added products and to explore new export markets. FDI was especially welcomed in the strategic industries, and the Government constantly amended the FDI laws to reflect this policy. The establishment of HSIP in order to attract FDI and local investors to invest in the production of high-tech products has also contributed a great deal to Taiwan's ongoing development.

PART THREE

LAW, FOREIGN DIRECT INVESTMENT AND ECONOMIC DEVELOPMENT IN TAIWAN, 1984-PRESENT

One can see from the detailed discussion in Part II that for many years the policy of the Government has been to promote FDI. Avoiding excessive economic nationalism, in accordance with Dr. Sun's *Min-Sheng* philosophy, the Government has used legal incentives to encourage FDI projects that are conducive to the economic development of Taiwan since 1954. This policy has also helped to shape a closer government-business relationship in Taiwan, that first grew out of a strong post-war economic recovery. As we have seen in Part II, the Government has been tempted, during earlier stages of its economic development, to resort to periods of import substitution and export substitution, along with other less market-oriented strategies, in order to stimulate economic development in the Republic. One thing is clear; whichever of the various models and policy techniques the government of Taiwan has employed to attract foreign capital, technology and other factors of production, FDI has been and remains a central element in the economic development plan of Taiwan.

In Part III the aim is to bring the historical discussion in Part II up to date, and to offer a description of the current legal framework for FDI in Taiwan. These Chapters are devoted to the salient current legal issues relating to FDI in Taiwan, including the forms of business activity, the regulatory oversight of FDI, issues relating to entry and exit, and the treatment of FDI in Taiwan. Chapter 8 sets out the basic economic policy underpinnings of modern Taiwan's FDI programme, along with policy developments since 1984 that have impacted on the nature of FDI in Taiwan. In Chapter 9 the purpose is to assess Foreign Investment Approved (FIA)

and non-FIA investment projects in terms of how they can be structured, and to note the merits of the various forms of business activities in Taiwan and their legal constraints. Chapter 10 considers the question what investments are eligible for FIA status in Taiwan? It discusses the basic requirements for admission of investments, including the concepts of foreign direct investment and legal issues regarding residence matters for foreign investors. Legal issues of encouragement and protection for foreign investors will be detailed in Chapter 11. In addition, relevant norms of international law will be examined as reference-points for the law and practice of the ROC. Where appropriate, critical comment on the present legal regime will be made, with suggestions for further reforms.

Chapter 8

Modern Government Policy and FDI Law Reform during the Industrial Upgrading Phase, 1984-Present

Even though FDI has always been treated by the Government as a crucial element in Taiwan's economic development, Taiwan's economic policies and the need for foreign exchange have made the FDI review process complex, delicate, time-consuming. The purpose of this chapter is to discuss the interaction between economic policy and FDI law reforms in Taiwan during the industrial upgrading phase. This chapter focuses mainly on how major economic policy shifts, as manifested in recent legal reforms, have reshaped the FDI environment and framework and the responses from FDI to the Government's modern FDI policy. It will consider, most notably, the impact of the Government's current economic policies - liberalisation, internationalisation, and institutionalisation - and other regulatory developments. The advent of political democracy, another factor to have affected Taiwan's FDI environment, will also be noted.

8.1 Modern Government Economic Policy

In the early 1980s, the world economy suffered its longest recession since the First World War. Almost every developed country had high inflation, high unemployment, and low economic growth. In order to ride out the stagnation, developed countries sought to increase exports to stimulate the growth of the domestic economy and they set up many non-tariff barriers to protect their domestic markets (Tuan, 1992: 293). This was especially true of the US, which had a serious balance-of-payments imbalance in the 1980s and therefore a strong penchant for protectionism. It very often used the Section 301 provision of the 1974 Trade Act to sanction its trade partners for unfair trade, in order to ensure fair and equitable

conditions for US commerce¹ (Schwab, 1995: 79-85; Hsing, 1995: 21). In addition, after the two major international oil crises, developed countries could no longer utilise cheap oil to develop their industries, and have had to change their economic structure to develop low-energy industries, such as the micro-electronic industry, in order to lower production costs. Meanwhile, to increase their products' competitiveness, MNEs relocated manufacturing lines and internationalised their production. Developing countries were enthusiastic to increase exports by fitting in with the strategy of MNEs. (Tuan, 1992: 358). These structural changes in the world economy have had an important influence on the economy of Taiwan.

Since 1981, when oil prices finally stabilised and then began to decline, Taiwan's trade surpluses became increasingly and persistently large (Lau, 1990: 204). In particular, the economic recovery of the US in 1983 provided Taiwan with an outlet for another export drive. The value of exports increased by more than 100 per cent from US\$ 30 billion in 1984 to US\$ 61 billion in 1988 (TSDB, 1997: 192). In 1987, the trade surplus reached a peak of some 18 billion and Taiwan's largest bilateral trade surplus, approximately US\$ 16 billion, was with the US (TSDB, 1997: 188, 194). By 1988, Taiwan had the second largest foreign reserves in the world, of approximately US\$ 79 billion (Chan and Clark, 1992: 90). The figures were not entirely positive: they not only put upward pressure on the exchange rate and growth of the money supply domestically² but also fanned protectionist sentiments abroad and forced Taiwan to open its market (Lau, 1990: 184; Copper, 1988; Seymour, 1989: 54-63; Simon, 1986: 42-51).

¹ The US Congress passed the Omnibus Trade and Competitiveness Act (OTCA) in 1988. Unveiled in the 1988 OTCA, the US 'Special 301' trade policy allows the US, in effect, to designate specific countries as unfair traders, and to threaten them with strong trade sanctions, such as higher tariffs, unless they change their trading practices (Moyer, 1994: 178-205).

² Before the law changed in 1987, private individuals and firms were not allowed to hold foreign exchange; they had to sell it to the central Bank of China in return for New Taiwan dollars. Because the Central Bank had to purchase the foreign exchange with New Taiwan dollars, this led, in turn, to a very rapid growth of money supply (Lau, 1990: 204).

Taiwan's economic structure became problematic in the early 1980s. On the one hand, facing competition from other developing countries and pressure from the increase of domestic labour costs, labour-intensive export industries in Taiwan became less competitive in overseas markets. On the other hand, Taiwan did not as yet have enough capital and technology to develop capital- and technology-intensive industries. Thus Taiwan's economy faced a new dilemma, and the Government had to adjust the country's economic structure and redraft its development strategy in order to foster continued growth.

By way of response, in 1984 the Taiwanese government adopted an economic policy of liberalisation, internationalisation and institutionalisation, with the underlying aim of upgrading Taiwan's industry (Yü, 1995: 257; Chiang, 1995: 170). This is still the ultimate target for the Government. It should be noted that the present 'industrial upgrading' policy differs from that of the 1970s. The latter was focused on developing Taiwan's heavy chemical industries, while the present policy targets Taiwan's information technology and precision machinery industries (Tuan, 1992: 136).

8.1.1 Liberalisation

(A) Import Liberalisation

Since the foreign exchange system was converted from a fixed into a floating system in 1979, import liberalisation has been emphasised because it supports export expansion through reducing the costs of acquiring intermediate products, and stabilises the foreign exchange rate. As the trade surplus decreases, it will become easier to accept foreign capital inflows and FDI - which are important, among other things, to technical progress, structural changes, and further export expansion (Kuo and Fei, 1985: 83).

In 1984, the Government embarked on an import liberalisation programme, lowering tariffs and abolishing import restrictions on thousands of commodities³ (Lau, 1990: 184; Hsieh, 1992: 18). The average nominal tariff rate fell from 7.61 per cent in 1982 to 4.97 per cent in 1991 and to 4.2 per cent in 1996 (Chiang, 1995: 170-171; *CDN*, May 20, 1997). The Government also eliminated direct and indirect export subsidies and essentially switched from a policy of promoting exports to a policy of encouraging imports (Hsing, 1995: 20). Imports of consumer goods have increased markedly. In 1988, domestic demand for the first time exceeded exports of goods and services, and became the main driving force behind the promotion of economic growth (Hsieh, 1992: 19). Liberalisation of import restrictions has also meant that local businesses can no longer hide under the umbrella of protectionism and have had to face direct competition from MNEs. This programme has had the twin effects of forcing local business into upgrading technology in order to survive, and, at the same time, of providing a fair competition environment for foreign investors in Taiwan.

(B) Currency Appreciation

The New Taiwan dollar was allowed to appreciate against the US dollar beginning in 1985, and by 1993 it had increased by about 57 per cent⁴ (Hsing, 1995: 19). This realignment of the US\$/NT\$ rate had three main causes. First, there was concerted international action to allow the US dollar to fall. The 'Plaza Accord' of the 'G-7' meeting set in motion a process of rapid US dollar devaluation against the Japanese Yen and the Deutschmark.⁵ The NT dollar had little reason to

³ There were no import products in the 'prohibited' category by 1990. In 1993, total import products in the 'controlled' category were only 2.4 per cent and 97.6 per cent of import products were straightforwardly permissible (Yü, 1995: 258).

⁴ In fact, the NT\$ had continuously appreciated, from NT\$ 40.40 per US dollar in 1960 to NT\$ 25.4 in 1992. The current exchange is around NT\$ 27.5 per dollar (*FCJ*, April 18, 1997).

⁵ Group of Seven (G-7) is a group of industrialised nations that constitute the Group of Five (the US, Japan, Germany, France, the UK) plus Canada and Italy (Rosenberg, 1994: 152). In September 1985, the G-5 met at the Plaza Hotel in New York. The Group agreed that "exchange rates

follow the US dollar down, and the peg was snapped. Secondly, NT dollar appreciation also resulted from explicit bilateral US pressure. The deemed undervaluation of the NT dollar was blamed for the persistence of the US deficit in bilateral trade, and Taiwan, along with its Asian 'tiger' partners, was the target of bitter US criticism for keeping its currency at an artificially low level (Long, 1991: 104). Thirdly, as foreign exchange reserves continued to grow, the public expected that further appreciation of the NT\$ was likely. Not only was the public reluctant to hold US dollars, but speculative money ('hot money') began to flow into Taiwan, seeking to take advantage of potential currency appreciation (Lau, 1990: 204-205). This put further upward pressure on the local currency.

The massive appreciation of the NT dollar from 1985 has had some advantages for the economy: it stemmed inflation and encouraged the import boom. Yet, in the meantime, the rapid appreciation of the NT dollar also had adverse effects: it not only raised labour wage rates in Taiwan and placed great pressure on production costs in the labour-intensive industries, but also made export-oriented industries internationally less competitive. In addition, the liberalisation of exchange rate controls has reshaped Taiwan's FDI environment. Many FDIs which were targeted at export or labour-intensive industries have either reduced their investments productivity or withdrawn from Taiwan and relocated to other developing countries, such as Malaysia and Thailand. The appreciation of the New Taiwan dollar and the rise in labour costs have diminished Taiwan's viability as an export manufacturing base.

should better reflect fundamental economic conditions than has been the case", and that "some further orderly appreciation of the main non-dollar currencies against the dollar is desirable". The participants announced that G-5 governments would "stand ready to co-operate more closely to encourage this when to do so would be helpful" (Colas, 1994: 354-355).

(C) Liberalisation of Foreign Exchange Controls

Taiwan's principal foreign exchange control statute has been the Statute for the Administration of Foreign Exchange (SAFE).⁶ Prior to 1987, SAFE generally required that foreign exchange earnings resulting from exports of goods and services should be sold to the CBC or to "appointed banks" - banks authorised by the CBC to engage in foreign exchange business (Article 7 of SAFE). This surrender system was used by the Government to control the use of foreign exchange and gave the CBC substantial discretion in channelling economic activities. Thus the Government used the right to repatriate foreign exchange as leverage with which to channel desirable foreign investment into Taiwan. Foreign investors whose investment projects in Taiwan were approved pursuant to a merit review regulatory process would enjoy the right under Article 13 of the SIFN and Article 12 of the SIOC to repatriate net earnings and capital gains in foreign exchange. Taiwan's investment incentive laws have thus been closely related to its foreign exchange control measures.

However, a shortage of foreign exchange - the basic premise of the SAFE - gradually ceased to be the case after the early 1970s, and the surrender system under the SAFE became too rigid despite such discretion. Indeed, Taiwan's substantial trade surplus, the accumulation of foreign exchange reserves, and the expectation of the NT dollar's appreciation created huge pressure for the Government to relax foreign exchange controls.

In June 1987, the SAFE was extensively amended. Article 26-1 of the Statute allows the Executive Yüan (the Cabinet) to liberalise the control of foreign exchange when economic circumstances allowed. It authorises the Executive Yüan to suspend the application of core provisions of the SAFE in whole or in part when

⁶ Promulgated on December 24, 1970 and revised on December 20, 1978, May 14, 1986, and June 26, 1987.

the ROC experiences a long-term international trade surplus or accumulates substantial foreign exchange reserves, or when the international economy experiences major changes (Liu, 1986-7: 298). Subsequently, the CBC in July 1987 suspended the SAFE's core provisions and implemented eight new regulations⁷ under Article 26-1, while retaining the foreign exchange control framework. Of these regulations, the most important are the Regulation for Non-Governmental Outward Remittances (Outward Remittances) and the Regulation for Non-Governmental Inward Remittances (Inward Remittances), because these two regulations are designed to relax the flow and retention of foreign exchange in Taiwan⁸ (Chiang, 1994: 135). After several amendments, the former now permits citizens and firms of the ROC to hold foreign exchange and to remit up to US\$ 5 million abroad per year without government approval (Article 4). The latter, governing the inward remittance of foreign exchange by nongovernment entities, stipulates that remittances into Taiwan may now be made free of controls up to a limit of US\$ 5 million per person per year (Article 4). Pursuant to the liberalisation process, all foreign exchange controls on current account transactions have been abolished, and controls over international capital movements have been significantly relaxed (Hsieh, 1992: 18). However, it is notable that the Government's control of foreign exchange is focused on quotas of inward and outward remittances per person per year, not the nature of transaction. The policy of neglecting the nature of transactions and of neglecting the forms of a transactions may result in some valuable economic transactions becoming impracticable. As

⁷ Those regulations are the Regulation for Central Bank of China's Supervision of Foreign Exchange Operations of Appointed Banks, Guideline for Operation of Foreign Exchange Business by appointed Banks, Regulation for Purchase and Sale of Foreign Exchange by Appointed Banks, Regulation Governing Collection Business for Foreign Credit Cards, Regulation for Establishment and Administration of Foreign Currency Exchange Counters, Regulation for Registration of Balance of Medium-term or Long-Term Foreign Debts Incurred by Private Enterprises, Regulation for Non-Governmental Outward Remittances, and the Regulation for Non-Governmental Inward Remittance.

⁸ The latest amendment for these two laws was on 15 March, 1991.

such, the policy appears to be at variance with the IMF's policy guideline to use the nature of a transaction to decide the legitimacy of foreign exchange controls.

The SAFE liberalisation led to an amendment of the SIFN and SIOC in 1989 and relaxation of FDI policy (see Chapter 8.2 below). As amended, the SIFN now sets out a 'negative listing policy', by listing only those industries and businesses in which foreign investment is prohibited or restricted (see Chapter 8.2 below). These reforms "have made the foreign investment process and review standard more transparent and less intrusive" (Liu, 1994: 134).

(D) Other Forms of Liberalisation

At the same time, the Government gradually relaxed restrictions on trade with communist countries. For political and ideological reasons, the ROC government used to have a strict policy prohibiting trade with communist countries. As the Government liberalised its trade policy, and in keeping with a more flexible foreign policy, most countries are now allowed to trade directly with Taiwan: the only exceptions are Cuba and the PRC, which trade with Taiwan indirectly (Chiang, 1995: 173). In addition, in order to attract foreign investment, the Government amended the FDI laws and simplified investment procedures to compensate for the NT dollar's appreciation and the increase of the labour wages. These measures led to a huge growth of capital inflows (see Chapter 8.2 below).

8.1.2 Internationalisation

The process of internationalisation has been conducted in both economic and political spheres. One of the Government's economic strategies was and is to take advantage of the strict quality and quantity controls of MNEs in order to upgrade Taiwan's industry. As one of an MNEs international manufacturing sites, Taiwan's industry would be well-placed to upgrade itself by using foreign technology or equipment (Tuan, 1992: 135). Of course, within this economic

development strategy, it becomes imperative to attract foreign investment by MNEs (see Chapter 8.2 below).

In order to diversify the sources of imports and the markets for exports, the Government has encouraged businesses to explore new suppliers internationally and to venture into new overseas markets, mainly focused on European countries. Correspondingly, as commercial activity in Asia and along the Pacific Rim increases and as part of its new 'flexible policy' regarding foreign affairs, Taiwan plans to seek membership in more regional and international organisations, and this will give it a larger voice in the international arena (Schive, 1992: 120). Taiwan joined the Pacific Basin Economic Council (PBEC), Pacific Economic Co-operation Council (PECC) and Atlantic Provinces Economic Council (APEC) in 1984, 1986 and 1991 respectively (Chiang, 1995: 172). By participating in the activities of regional economic organisations, Taiwan not only enlarged its activity space internationally but has also brought itself back on to the international stage. In addition, Taiwan became a colloquium partner in OECD in 1989, and more importantly, Taiwan became an observer in GATT in 1992.⁹ The next target for Taiwan is to join the World Trade Organisation (WTO). In all, 26 countries have requested individual trade negotiations with the ROC to discuss the terms of its WTO membership application. Taiwan has now completed 20 bilateral talks for full support of the ROC's membership in WTO (*CDN*, July 23, 1997), and 13 countries have signed bilateral agreements with Taiwan (*CDN*, May 10, 1997).

⁹ In order to avoid the assertion of statehood, the ROC used the name of "The Separated Customs Territory of Taiwan, Penghu, Kinmen and Matsu" (referred to as Chinese Taipei) for its application to join GATT. The ROC officially began an attempt to join GATT in 1987 by forming an *ad hoc* committee to lay the groundwork (*Commercial Times*, December 27, 1987). This committee completed a report in 1988, which included a recommendation to join GATT and procedural plan (*FCJ*, November 10, 1988; *Economic Daily News*, December 7, 1988). Also, see Shaw (1991: 163); *Keesing's Record of World Events* (1990: 37671).

8.1.3 Institutionalisation

This policy is aimed at maintaining a good trade order. By institutionalising Taiwan's trade measures and targets, liberalisation and internationalisation can be implemented more smoothly.

In essence, before 1993 Taiwan's foreign trade was regulated by rules promulgated by different Government's agencies (CEPD, 1990: 125). This was, in fact, inconsistent with Article 107 (XI) of the Constitution, which required that international trade policy should be promulgated and executed by the Central Government. For institutionalisation, the Government promulgated the Foreign Trade Act¹⁰ on February 5, 1993, the spirit of which was substantially influenced by the US Omnibus Trade and Competitiveness Act of 1988 (*Economic Daily News*: February 28, 1993; *China Times*, February 17, 1993). The Foreign Trade Act contains a number of features. It adopts a 'negative list' for imports and exports of commodities - in other words, the import and export of commodities are by default liberalised, except for those commodities on the control list (Article 11). Other measures include countervailing or anti-dumping duties to be imposed on unfair trade partners (Article 19); military procurement to be included in the export and import statistics (Article 12); and for the MOEA to organise a trade investigation committee for import relief if an industry is suffering from or threatened by an import commodity which increases sharply in value or in quantity (Article 18). The Act is an important step forward in the internationalisation and liberalisation of trade policy, and signifies the modernisation of Taiwan's foreign trade regime.

8.1.4 Other Economic and Political Influences

The US management expert Michael E. Porter (1990) has divided a nation's economic development into four stages - driven successively by production,

¹⁰ The Foreign Trade Act is also known as Constitution Law of Trade in Taiwan (*CDN*, April 26, 1993).

investment, innovation and wealth. He has argued that Taiwan is now at a critical juncture of moving from the investment-driven stage to the innovation-driven stage, wherein R&D is essential to further development (*FCJ*, April 11, 1997). With the rising value of the NT\$, many traditional industries, such as textiles and shoes, became uncompetitive in the world market, and firms were forced to either close down or contract drastically. Other industries, especially agriculture, became threatened by potential imports. The necessity of industrial upgrading became obvious, and the Government has itself funded large-scale industrial research and development (R&D) projects.¹¹ Such Government support may well be necessary given Taiwan's particular mode of industrialisation, which relies on a large number of diverse but relatively small firms. The advantages of this mode of industrialisation are an equitable distribution of income, social mobility, and flexibility. The disadvantage is that few firms are large enough and financially strong enough to undertake long-term and high-risk investments, especially in R&D (Lau, 1990: 185).

The CEPD began shifting the emphasis in industrial restructuring, stressing technology-intensive, non-pollution, and low energy-consumption industries, instead of heavy or capital-intensive ones. Its Ten-Year Plan for 1980-89 and Four-Year Plan for 1982-86 reflect this priority. The CEPD devised a new incentive package to channel capital into strategic industries such as information technology, telecommunications, and semiconductors. It planned to let value-added, labour-intensive industries such as textiles and footwear contract (Gold, 1990: 102). The CEPD's goal was to continue to utilise export demand to guide production but to nurture Taiwan's own research and development (R&D) capacity to develop new products, raise value added, and vertically integrate the electronics sector (Gold, 1990: 103).

¹¹ In 1996 the Government spent about 1.8 per cent of GDP on R&D. The total amount spent on R&D by the Government is expected to reach 2.5 per cent of GDP by 2000 (*CDN*, April 14, 1997).

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In order to help Taiwan move towards a domestic demand-oriented economy with a special focus on the high technology industries, the Government started an 'Information Technology Development Plan' (1982-1989) and added information industry as one of the strategic industries in 1982. Additionally, in order to develop high-tech industry, the Government, Phillips International and local investors combined to invest NT\$ 10 billion and established the Taiwan Semiconductor Manufacturing Corporation (TSMC) in 1987; semiconductors also became a designated strategic industry (Shih, 1994: 313-314).

The Government in 1993 announced that it will build Taiwan into an Asia-Pacific Regional Operations Centre - sea transportation, air transportation, telecommunications, finance and media, and science and technology hub (*FCJ*, April 11, 1997). However, it is submitted that this economic target will probably become no more than a slogan. For example, Taiwan will not be unique as a transshipment hub because Hong Kong and Singapore discharge similar roles. However, Taiwan's position in science and technology is unique, distinctive and more advanced than most Asian economies. Information technology is one of the target industries in Taiwan. Taiwan currently ranks No. 1 for global market share in nine categories of information technology products (*FCJ*, April 18, 1997). In addition to the information technology industry, the semiconductor industry has become another important industry in Taiwan. It is estimated that the Taiwanese semiconductor industry will occupy about 8 per cent of world market share in 2000 (TIER, 1996: 125). Taiwan is expected to become the top 4M DRAM (dynamic random access memory) producing country in 1997 (*CDN*, April 18, 1996). If the Taiwanese government can develop Taiwan's scientific potential and modify its rather overambitious proposal into a simplified plan for a science and technology hub, it will be more practical and may well improve Taiwan's competitiveness in the world.

On the political and social fronts, there has been a considerable sea change. On July 14, 1987, martial law, which had been in place for almost 40 years, was lifted in Taiwan. The Emergency Decree was also formally replaced in July 1987 by the National Security Act. While the abolition of martial law had little direct impact on Taiwan's politics, it marked a symbolic break with the past and opened the way for many of the later reforms (for example, the legalisation on new political parties) (Chan and Clark, 1992: 91-92; Gold, 1989: 87-108). In addition, the bans on new political parties and newspapers were also removed. These actions indicated significant progress toward democracy and respect for human rights in Taiwan. The cancellation of the 1948 Temporary Provisions in 1991 ended the domination of the national legislature (Legislative Yüan) and the electoral college for the president (National Assembly) by Mainlander senior legislators elected to their seats in the late 1940s - arguably the principal barrier to the full realisation of democracy in Taiwan (Chan and Clark, 1992: 93). In the decades when the ROC Constitution gave the power to choose the head of state to the National Assembly, the election system was a comparatively closed one. The contenders were limited exclusively to senior members of the ruling KMT (*FCJ*, March 8, 1996). In 1990, the Judicial Yüan (Taiwan's Supreme Court) ruled that all legislators elected before 1949 must retire by the end of 1991 (Chan and Clark, 1992: 93). In 1992, a new National Assembly was elected to revise the 1947 Constitution Law and in 1994 these constitutional revisions required the president to be elected by the general populace (*FCJ*, March 8, 1996). The March 23, 1996 presidential election, the first under the new rules, marks a significant political liberalisation in Taiwan. The KMT's candidate Lee Teng-hui is the ROC's first popularly-elected president (*CDN*, March 24, 1996).

The arrival of political democracy since the late 1980s has had a profound influence on Taiwan's FDI environment. Indirectly, for example, it has affected the nature of the labour force and labour costs in Taiwan. One of the foundations of

Taiwan's economic success has been its labour force. In the past, labour supply has proved flexible, cheap, productive and, by and large, docile. The Labour Standards Law was passed on July 30, 1984, strengthening protection of the rights of workers. Under martial law, strikes were effectively illegal. With the lifting of martial law in 1987, labour unions have become more active and militant in their wage and other demands (Lau, 1990: 186). A package of more liberal labour legislation was urged. The Labour Standards Law was revised in 1987 and sets minimum ages, hours, annual leave and pension arrangements (Long, 1991: 103). For foreign investors, Taiwan's traditional comparative advantage as a low-cost assembler has become a thing of the past.

8.2 Government Policy and the Reform of the Laws on Foreign Investment

8.2.1 Government Policy on FDI

In the 1980s, because wage rates were rising, land was becoming more expensive, and environmental controls were becoming stricter, Taiwan could no longer compete in making sports shoes, handbags, plastic toys and in similar low-tech areas where labour costs matter more than technology and capital. Investment incentives had been directed to facilitate investment in the high technology industries with the introduction of special incentives, and with the establishment of more Science Parks. A second science-based industrial park has been constructed in Tainan, south of Taiwan (*FCJ*, January 20, 1995). It is also treated as part of the Government's plan to build Taiwan into a science-and-technology island and a regional operations centre. Hsinchu and Tainan Science Parks host both domestic and foreign companies engaged in high technology industries. As has been mentioned, this initiative was geared not only to attract FDI, but also to broaden the industrial base and upgrade domestic skills.

In order to upgrade domestic industries as well as achieve its targets of economic development, internationalisation and liberalisation, the Government's present FDI policy is to encourage investment in high technology industries in order to help build Taiwan into the envisaged Asia-Pacific Regional Operations Centre (FCJ, April 18, 1997).

8.2.2 The Reform of the FDI Laws

(A) The Revision of Statute for Encouragement of Investment and the Promulgation of Statute for Upgrading Industries

Under the Statute for Encouragement of Investment, the Government regularly promulgated and upgraded lists of products and services that would be entitled to investment incentives under the SEI. Lately, these lists have become more higher-end, higher-tech, and higher-value-added oriented. Similarly, the policy of the Government in recent years has been to foster as many capital- and technology-intensive investment projects as possible. The SEI enacted in 1960 was amended in 1984 and 1987. The revised SEI, effective December 30, 1984, strengthened a provision requiring industries receiving benefits under the SEI to spend a standard amount of money on R&D (Article 35). 'Public Facility Construction and Development' was added as one of the 'productive enterprises' in order to encourage investment in public construction (Article 4). The 1987 SEI amendment provided added incentives for investment in venture capital investment enterprises; e.g., 80 per cent of the income derived from such investment can be excluded from taxable income (Article 16-3).

The SEI has now been replaced by the Statute for Upgrading Industries (SUI), effective from January 1, 1991 to June 30, 1998.¹² The SUI is designed to

¹² The Enforcement Rules of SUI were promulgated on April 1, 1991, and details on the SUI's investment tax credits in the purchase of equipment and technologies were announced on April 15.

encourage both domestic and foreign investment, and is directed toward investment activities rather than specific industries like SEI. As in the past, the Government considers tax incentives to be the most effective form of encouragement. Certainly a five year tax-holiday is a very strong incentive for investors. However, when Taiwan's economic development is approaching that of fully-developed countries,¹³ fair distribution may become more important than rapid growth (*New Taiwan News*, February 9, 1990). According to Government data, the total amount of tax-exempt income exceeded NT\$ 300 billion by 1990 (*Commercial Times*, February 2, 1990). Under the SEI, on the one hand, the Government subsidised industrial development and distorted the distribution of resources; on the other hand, it created an unfair tax system and a distorted competition environment (*Commercial Times*, January 29, 1989). The SUI, however, encourages industrial upgrading by allowing a company to credit 5%-20% of amounts invested for specified purposes - such as investment on equipment for automation of production or production technology and investment on R&D - against its income tax (Article 6). While the SUI incentives are applicable to both foreign and domestic investments, without a five-year tax incentive, they appear to be less attractive than were incentives under the SEI. This is evidenced by the fact that approved FDI dropped from US\$ 2,418 million in 1989 to US\$ 1,213 million in 1993 (see table 5.1). Consequently, the SUI was amended on January 27, 1995. In particular, to encourage the incorporation or expansion of 'important technology-based enterprises', Article 8-1 of the 1995 SUI stipulates that such enterprises can enjoy a five-year income tax holiday.¹⁴

¹³ IMF has reclassified Taiwan, Singapore, Hong Kong, South Korea and Israel as industrialised countries in its 1997 *World Economic Outlook*. They are termed 'advanced economic entities' in the report (CDN, May 24, 1997).

¹⁴ The scope of application of the terms 'important technology-based enterprise', 'important invested enterprise' and 'venture capital investment enterprise' is prescribed by the Executive Yuan and subject to review once every two years (Article 8 (II) of 1995 SUI).

(B) The Revision of the Statute for Investment by Foreign Nationals and of Statute for Investment by Overseas Chinese

The Statute for Investment by Foreign Nationals and Statute for Investment by Overseas Chinese were each revised twice in 1986 and 1989. Those amendments reflected shifts in Government FDI policy. For example, Article 13 of the 1986 SIFN allowed investors to remit the whole amount of invested capital after one year of investment. (Investors could only remit 15 per cent of the invested capital before the 1986 amendment.) Also, foreign company allow to set up a manufacturing branch in Taiwan and to forsake privileges and benefits under the SIFN (Article 6 of the SIFN). Furthermore, as mentioned earlier, in May 1988 the Government announced a 'negative listing policy' for FDI applications. The Government had until then only allowed foreign shareholdings in approved industries, an approach known as 'Positive Listing'; under which the permissible industries were exceptions rather than the general rule, and most industries were allowed no room for foreign shareholdings under the SIFN or SIOC. Gradually, the Government broadened the range of permissible industries, and the Positive List was replaced by the 'Negative List' in 1989, a liberalisation in the sense that, except for industries on that list, all industries were deemed open to FDI.¹⁵

The Negative List was revised on July 11, 1990. The List contained 54 prohibited industries and 55 restricted industries for investment by foreign nationals

¹⁵ The industry classifications and categories in the negative list are not exhaustive. The 1989 amendments which incorporated the negative list also prescribed a general prohibition against FDI from being made in the following categories of activity: (a) those against the public safety and security; (b) those against good morals; (c) those having a high rate of pollution; and (d) those having monopoly privilege or protection from investment by investors by laws (Article 5 (I) of SIFN and SIOC). The SIFN and SIOC, as amended, also requires that FDI in any of the following industries be approved in advance by the agencies having primary jurisdiction over such industries and that approval shall be made in accordance with the regulations adopted by the primary jurisdiction agencies: (a) public utility; (b) financial and insurance; (c) news media and publication; and (d) industries in which FDI is restricted by law or regulations (Article 5 (II) of SIFN and SIOC).

and 43 and 44 for overseas Chinese.¹⁶ The List was further amended on July 24, 1996, and both prohibited and restricted industries for foreign nationals and overseas Chinese investment have been considerably reduced. Liberalisation of FDI policy, thus, has continued.

8.3 FDI during the Industrial Upgrading Phase

Because of appreciation of the local currency, higher labour costs and land prices, and increasing pressure to consider environmental issues, levels of approved FDI dropped sharply between 1989 and 1993 (see Table 5.1). The Government's strategy of upgrading Taiwan's industrial structure away from the no-longer viable labour-intensive, low-technology industries conflicts with the objectives of the MNEs that originally went to Taiwan for just those things (Gold, 1988a: 199). The appreciation of the NT dollar and the rise in labour costs owing to labour's new militance effectively ended Taiwan's viability as an export manufacturing base. Thus, during this period, many Japanese and US investors who had come to Taiwan to take advantage of cheap labour either left or were planning to leave. Nonetheless, this did not lead to a net decrease in foreign investment inflows. Rather, many of the new investments, e.g., by foreign banking operations, were geared not at producing exports to the US but at penetrating the local economy to take advantage of Taiwan's new prosperity. These were precisely the investments that were perceived as threatening the interests of the local enterprise blocs that had traditionally controlled the domestic market (Bello and Rosenfeld, 1990: 248).

Because Taiwan has a good international balance of payments position, MNEs do not derive leverage from their ability to bring in capital to Taiwan. Thus, MNEs' bargaining position depends more on their control of the technology that

¹⁶ See *Tsung-t'ung fu-kuan-pao* (1990).

Taiwan needs to upgrade its industry, and on their access to the markets that can absorb Taiwan's output. But the strongest element in their package is that they contribute another tie between Taiwan and other entities with legitimacy in international affairs. Many MNE offices have taken the place of embassies in Taiwan.

Since 1984, Japan has been the largest foreign investor, accounting for US\$ 5,533 million of approved investment between 1984 and 1996, while the amount of approved US investment during this period totalled US\$ 5,157 million. European investment reached US\$ 2,545 million for the same period, while Overseas Chinese accumulated US\$ 1,961 million (TSDB, 1997: 242-244). The above four categories of foreign investors generally have a different sectoral focus for their investment strategies in Taiwan.

Since 1984, overseas Chinese have been responsible for about 10 per cent value of total foreign investment in Taiwan, with private foreign nationals representing the rest (see table 5.2). Incoming investment during this period has been concentrated mostly in five sectors: electronics and electrical appliances, chemicals, service, transportation, and finances and insurance (*FCJ*, December 15, 1995).

The size of Overseas Chinese investments in Taiwan is generally small (averaging US\$ 3.1 million per investment between 1991 and 1995, for example) and nearly three-quarters of these investments are joint ventures. Overseas Chinese investments are concentrated in the light industrial, service and speculative sectors (such as construction and real estate), where Taiwan's local investors are active. Coming in many cases from countries less developed than Taiwan, they contribute little in the way of advanced technology, either in the goods they make or in manufacturing techniques (Gold, 1988a: 198). According to Government information, overseas Chinese investment from Hong Kong in particular has

increased during the 1990s (*CDN*, March 23, 1997). Most capital has come from Hong Kong Chinese who sought political insurance against Hong Kong's 1997 return to Chinese sovereignty.¹⁷

From Table 5.2 one can see the relatively large size of individual US investments. Between 1991 and 1995, for example, US cases represented 16 per cent of the total but 28 per cent of the capital. The average American investment was US\$ 8.44 million. Most of the investment is in the form of wholly owned subsidiaries with initial capital supplied by the parent firm (Gold, 1988a: 195). Starting in the 1980s, American fast-food companies began operating in Taiwan. Some, such as MacDonalds, were extremely successful. Other service-sector industries, such as insurance and transport, entered the market in the mid-1980s. Of significance also is that the Government's strategy of upgrading industry is having some success in getting Americans to buy locally and to invest in high-technology upstream operations (Gold, 1988a: 199). For example, the world's leading seller of personal computers, Compaq of the United States, currently has plans to inject US\$ 5 billion annually into Taiwan for setting up a product research and development centre. The establishment of Compaq's R&D centre is expected to upgrade the technology and quality control of PC products manufactured in Taiwan, and to reduce production cost and time (*FCJ*, March 14, 1997).

The Japanese investors in Taiwan are much more diverse than their American counterparts. At one extreme are large companies such as SONY, Sharp, Matsushita, and Hitachi. But the majority are small and medium-size enterprises that operate as subcontractors and suppliers to the giants in Japan (Gold, 1988a: 196). Although Japanese investments accounted for 32 per cent of the total approved cases between 1991 and 1995, they presented only 24 per cent of the total

¹⁷ Those Hong Kong citizens did not apply an Overseas Chinese Identification Cards before Hong Kong reverts to Chinese rule (July 1, 1997) are no longer possess overseas Chinese status in the ROC (July 1, 1997, *The China News*).

capital. The average investment was US\$ 3.5 million (see table 5.2). Nonetheless, this represents a rapid increase in size over time, as the upward valuation of the yen, combined with Japan's industrial restructuring, pushed a number of larger firms to Taiwan. Most Japanese investments in Taiwan are joint ventures with local entrepreneurs, where product development is almost always done in Japan (see previous Chapter 6.4 about MITI's strategy). Even in these joint ventures with local investors that involve technology licensing, the Japanese tend to keep the key elements secret. Electronics and pharmaceuticals are frequently-cited examples of this practice (Gold, 1988a: 197). Despite the lack of technological benefit, however, in order to reduce Taiwan's huge trade deficit with Japan the Government has aggressively encouraged investment from Japan in recent years. Its efforts appear to be paying off. In 1995, Japanese entrepreneurs poured US\$ 569 million into new projects in Taiwan, the highest Japanese investment figure since 1991 (TSDB, 1997: 244).

In order to diversify the origins of FDI, the Government welcomes FDI from countries other than the US and Japan, especially targeting FDI from European countries. The Government utilises various exhibitions and advertisements in European countries to attract keen investors. Approved investment in Taiwan from European countries has significantly increased, from US\$ 20 million in 1983 to US\$ 334 million in 1995 (TSDB, 1997: 244). From 1991 to 1996, European investors represented 13 per cent of total approved FDI in Taiwan. The average investment amount is about US\$ 5.46 million, which is smaller than the average US investment (US\$ 8.44 million) but larger than the equivalent Japanese (US\$ 3.5 million) and overseas Chinese (US\$ 3.1 million) investment (see table 5.2). European investors tend to be the most export-oriented investors among all FDI in Taiwan. More than 95 per cent of their manufacturing products are exported (*CDN*, May 29, 1997).

Apart from the US, Japan, and European countries, investment from other countries has also increased during this industrial upgrading phase (see table 5.2). This result reflects one of the key elements of Government FDI policy and economic policy - diversification and internationalisation.

The composition of FDI, in terms of both geographic origin of investors and sectoral distribution, reveals the success of Taiwan's FDI policy. Taiwan now hosts a wide variety of American, European, Japanese, and other foreign-invested companies of varying sizes and in different industries, covering a wide spectrum of the country's economy (Liu, 1994: 131). Several trends are discernible in the recent wave of FDI into Taiwan. First, the foregoing concentration of FDI dovetails with the focus of Taiwan's current economic policy: capital- and technology- intensive investment. This trend is expected to continue because of the strong commitment by the Government to upgrade its industries. Secondly, the representation of FDI in Taiwan's service industry has increased. There is still much room for growth in this industry, especially in the area of financial and insurance services. Thirdly, the likely growth industries in Taiwan in the 1990s are health, environmental protection, and leisure-related industries. Finally, one expects benefits to accrue from a greater linkage between foreign and domestic investment in jointly-funded activities. At the same time, there will be more strategic alliances across national borders.

Taiwan has the best investment climate among 35 newly-emerging economies around the world, according to the latest survey by the *World Paper* (FCJ, March 7, 1997). In addition, on the latest survey by Business Environment Risk Intelligence (BEIR), Taiwan ranks third, behind Switzerland and Japan, for "Profit Opportunity Recommendation" among the other 50 countries (BIER, 1996; CDN, May 20, 1997). By liberalising FDI laws and improving the investment environment, Taiwan has made itself a popular place for foreign investors. FDI in Taiwan is expected to grow by 11 per cent in 1997. Private investors are becoming

more willing to invest in Taiwan because of new government initiatives, including the crackdown on underworld interference in major construction projects. Another incentive has been the opening up of telecommunication and power-generation services to private participation. Foreign capital will also be permitted to invest in local property in 1997 (*FCJ*, March 28, 1997).

8.4 Conclusion

At present, upgrading Taiwan's industry, building a more internationalised and liberalised investment environment in Taiwan, and making Taiwan into a Asia-Pacific regional operational centre are still goals for the Taiwanese people. In order to advance these goals, Taiwan is using tax incentives on specific investments plus the new Tainan science and industry park, which combines the economic benefits of an EPZ with ultramodern R&D facilities. It is also willing to invest as a partner where needed. In addition, the Government has shown preparedness to streamline administrative approvals, relax regulations, improve infrastructure, and increase efficiency in the legislative system because Taiwan must convince foreign investors in high-technology industries that Taiwan has something to offer them that they cannot get domestically or in other countries. For example, Taiwan PC makers currently rank No. 1 in the world in the production of motherboards. Taiwan is also a leading global supplier of semiconductors. These two facts alone make Taiwan a very attractive investment site for foreign computer companies.

The Government is constrained in upgrading industries, however, by the reality that it cannot push MNEs too far. It cannot be too 'nationalistic' because it is not a nation in the eyes of most of the world. Moreover, as the KMT retrenches from its unchallenged dominance over society, replacing martial law and a one-party system with more pluralistic electoral politics, its ability to mobilise society and ensure a stable investment climate will be compromised.

Chapter 9

Foreign Direct Investment and Forms of Business Activity in the ROC

It is accepted that a state may impose conditions upon the entry of an alien, and this principle includes conditions imposed upon foreign investors. It is also generally accepted that a state may institute measures to keep out foreign investment that is considered harmful to its interests (Sornarajah, 1994: 100-103). The sovereign right of the host state to regulate the admission of private foreign investment, including the right to exclude certain types of investments from its territory, is recognised by the World Bank Guidelines on the Treatment of Foreign Direct Investment (the 1992 Guidelines) (Shihata, 1993: 73-77). Section 3 of Guideline II reads:

“Each State maintains the right to make regulations to govern the admission of private foreign investment. In the formulation and application of such regulations, States will note that experience suggests that certain performance requirements introduced as conditions of admission are often counterproductive and that open admission, possibly subject to a restricted list of investments (which are either prohibited or require screening and licensing), is a more effective approach.” (31 *I.L.M.* [1992] 1381)

Taiwan follows this approach. As a general principle, any foreign national and overseas Chinese may establish a company under the laws of the ROC provided the investor does not engage in those activities from which foreign nationals and overseas Chinese are excluded, such as fisheries and electric light and power supply (see Negative List).¹ Although a foreign investor can, without getting prior governmental approval, establish a company within the laws of the ROC, the

¹ Article 12 of the Law Governing the Application of the General Principles of the Civil Code (promulgated on September 24, 1929; amended on January 4, 1981) provides “Within the limits prescribed by law and ordinances, a recognised foreign juridical person has the same capacity of enjoying rights as a Chinese juridical person. A foreign juridical person mentioned in the foregoing paragraph is under the same obligations as a Chinese juridical person.”

corporation must then operate as a local company would. The investor will not be able to take advantage of the rights and privileges accorded a foreign investor under the Statute for Investment by Foreign Nationals and Statute for Investment by Overseas Chinese, such as the right to repatriate earnings and capital.

This chapter has two aims. First, it provides a general overview of the ways in which Foreign Investment Approval (FIA) and non-FIA investments can be structured in Taiwan and their ramifications. Second, it analyses the four different forms of business activity most frequently adopted by foreign investors and the legal issues involved in their creation. Between them, the laws regulating FIA and non-FIA investments embody the practical upshot of the Government's policy of encouraging FDI while controlling it through regulation. In a sense, it is the bridge between policy and the current legal framework (surveyed in Chapter 10 and 11) which is the subject of this chapter.

9.1 Foreign Investment Approved and Non-Foreign Investment Approved Foreign Direct Investment

Broadly, there are two ways of structuring a foreign investment project in Taiwan: as Foreign Investment Approved (FIA) investment and as non-FIA investment. In other words, there is an 'FIA track' as well as a 'non-FIA track' for foreign investment in Taiwan. In order to assess the merits of these alternatives, the respective legal structures must first be examined. The discussion of FIA and non-FIA investment in this section will be used to serve this aim.

9.1.1 Foreign Investment Approved Investment

A FIA investment in Taiwan will be eligible for certain incentives and benefits set forth in statutes aimed at encouraging foreign investment. The most relevant statutes are the SIFN and SIOC, which set forth guidelines regulating the

various aspects of investment made by foreign nationals and overseas Chinese in the ROC.

In order to enjoy privileges and benefits under the FDI laws, foreign investors intending to make a direct investment in Taiwan, whether in the start-up or expansion phase, must submit an application which consists of the investment plan and other relevant documents to the Investment Commission of the Ministry of Economic Affairs (MOEA) (Article 8 of SIFN and Article 7 of SIOC). The Investment Commission then approves or disapproves the investment plan, with the former in a few rare cases accompanied by certain conditions and restrictions. This kind of company is generally called an FIA company. The FIA route is often the best means to structure a foreign investment project in Taiwan simply because the Government offers many incentives to FIA companies. Indeed, in approving a foreign investor's application under the investment statutes, the government is actually granting certain concessions of its rights, authority, and privileges, which will be discussed in more detail in Chapter 11 below.

FIA companies in Taiwan can be established in the form of either a branch office or a subsidiary company of the foreign company, generally to engage in manufacturing industries. Certain service industries now also qualify for FIA, but may only be organised in subsidiary form. Foreign investors are permitted to hold 100 per cent of the shares in FIA subsidiary companies (Article 18 of SIFN and SIOC).

Article 2 of the ROC Company Law provides for four types of business organisations: unlimited company (similar to the English equivalent), limited company (corresponds to an English private company limited by shares), unlimited company with limited liability shareholders, and company limited by shares (corresponds to an English public company limited by shares). In order to be a recognised form of business organisation, a business other than a sole

proprietorship or partnership must be organised in accordance with the ROC Company Law (Article 1).² Before 1986, most FIA investments used the form of a subsidiary, normally a company limited by shares incorporated under Article 98 of the Company Law. This was for two reasons. First, only companies limited by shares are eligible for tax benefits under the SEI (Article 3 of SEI). Secondly, the Government did not allow branch offices of a foreign company to engage in manufacturing industry. This was in part because the non-FIA investor might otherwise invest in those industries which could compete with local enterprises,³ but also because the foreign company would own a 100 per cent share of the branch, leaving no room for local Taiwanese to participate (Kuo, 1989: 446-447).

However, after the SIFN was amended in 1986, it is also possible to establish an 'FIA branch', which is duly recognised as conducting business in Taiwan, provided the FIA branch engages in productive or manufacturing operations (Article 6 of SIFN). Compared with setting up an FIA manufacturing subsidiary, an FIA manufacturing branch can offer foreign investors more flexibility to take advantage of favourable tax rules in their home country (Liu, 1994: 137).⁴ So far, the SIFN contemplates only these two forms of FDI.

9.1.2 Non-Foreign Investment Approved Investment

Non-FIA enterprises may also do business in Taiwan but will not be able to enjoy the special benefits discussed above. In principle, the Government requires validation of a foreign investment only if the investor wishes to have the rights and

² This is not to say that individuals may not get together to do business, but rather that if they wish to be accorded the advantages of doing business in a formal organisation, they must organise under the Company Law (Wang, 1985: 516).

³ A proposed FIA investment of this sort could be controlled by the FIA approved mechanism.

⁴ Digital Equipment Corp. was the first company to 'convert' its FIA manufacturing subsidiary in Taiwan into an FIA manufacturing branch (Liu, 1994: 180).

privileges provided in the SIFN and SIOC. These rights and privileges include the right to repatriate capital and earnings in foreign currency (Article 12 of the SIFN and Article 13 of the SIFN). However, if a foreign investor does not deem it necessary to enjoy such rights, no special government validation is required. A foreign investor must, of course, still comply with government regulations and relevant laws, as must any local investor.

In many developing countries, such as Spain and Sudan,⁵ foreign investors must obtain a licence (an approval) from a competent authority before taking any step in setting up the investment. This authorisation is because, on the one hand, the government wants to protect some monopoly industries and, on the other, the government hopes to channel the FDI into its preferred industries. The question may then arise: why does the ROC government allow foreign investors to make investments without specific approval? It appears that non-FIA investments were the result of foreign investment laws and regulations being formulated at a time when Taiwan was experiencing a shortage of foreign exchange in the 1950s. Given this framework and the administrative policy governing FDI, a project not deemed useful to Taiwan at the time (e.g. a trading business) would not receive the FIA or similar CBC approval under the Statute for the Administration of Foreign Exchange (SAFE). In order to get as much foreign exchange as possible and not to deter foreign investors from proceeding with their investment in Taiwan, the Government therefore also allowed foreign investors to set up a non-FIA company.

In fact, before the SIFN and SIOC were amended in 1989, some foreign nationals or overseas Chinese did choose not to proceed with the FIA review, because their projects would not be able to qualify for investment under the positive listing policy of the SIFN and SIOC. Although lacking approval, the investors could still organise either a subsidiary or a branch. But they were not able to

⁵ See Garcés (1976) and El Sheikh (1984).

repatriate the ‘blocked profits’ of these non-FIA subsidiaries and non-FIA branches.⁶

The right to repatriate earnings and capital is especially significant to a foreign investor. Before the control of foreign exchange was lifted in 1987, without the privilege of remitting out foreign currency, the profit of the company would have to stay in the ROC. In addition, if the foreign capital stays within the country for more than 6 months, it will not be permitted to be repatriated.⁷ As a result, many foreign investors who did not obtain the privileges afforded by the SIFN or SIOC were either reluctant to invest or tried to incorporate non-FIA business entities ‘thinly’, so that operations could be maintained at the necessary level without earning sizeable profits that could not be repatriated from Taiwan.

The Outward Regulations, adopted in 1987 as part of the foreign exchange liberalisation (see Chapter 8 above), have largely alleviated this problem. The annual quota of outward remittances is US\$ 5 million per person under the Outward Regulations (Article 4). Because the remittance quota is granted by a *regulatory* measure rather than by a *statutory* authorisation like the SIFN, it is more

⁶ However, Taiwan has had a foreign exchange black market, which is believed to be quite sizeable. This has shrunk since the foreign exchange liberalisation in mid-1987.

⁷ Article 6 of the Regulations Governing the Limitation on the Amount of Gold, Silver, Foreign Currency and New Taiwan Dollars Carried by Inbound and Outbound Passengers (promulgated on February 28, 1955; as last amended on September 15, 1980):

“1. Passengers entering Taiwan must declare to Customs the amount of gold, silver, and foreign currency they are carrying. The foreign currency may be converted into New Taiwan dollars in accordance with the prevailing rates. However, the gold and silver are not convertible and may be stored with the Customs Authority by the passenger. The passenger then is permitted to bring those declared and stored gold and silver with him when he departs. As to the foreign currency, only the difference of the amount declared and the amount converted into New Taiwan dollars is permitted to be carried out.

2. When the above-mentioned passenger departs after remaining in this country for over six months he is still allowed to carry the stored gold and silver with him. But the amount of foreign currency permitted to be carried out shall be limited in accordance with the restrictions applying to ordinary passengers”. In other words, they allow to carry out only US\$ 5,000 and NT\$ 40,000 when departing (DGC, 1994).

susceptible to a change in the administration of foreign exchange policies.⁸ It should be noted, however, that many foreign investors believe that the risk of an adverse change in the Outward Regulations is not significant enough to preclude the setting up of a non-FIA subsidiary or a non-FIA branch in Taiwan.

Inward remittances present few difficulties for non-FIA investors. They need only to comply with the requirements of the Inward Regulations, and the US\$ 5 million annual quota for inward transfers under Article 4 of the Inward Regulations is usually adequate for a foreign investor to fund the initial capital needs of its non-FIA entity in Taiwan (Liu, 1994: 137).

(A) Limitations on Non-Foreign Investment Approved Investments

Apart from the fact that non-FIA investments cannot enjoy the benefits and protection of the SIFN and of the SIOC, there currently remain certain other limitations for such investment.

First, a non-FIA company is set up according to the ROC Company Law. The investment is carried out with New Taiwan Dollars and is subject to restrictions regarding local residence, nationality, and investment amount as stipulated in the Company Law.⁹ For example, foreign investors cannot contribute more than 50 per cent of the total amount of capital of a non-FIA company;¹⁰ while for the FIA investment, the investors may invest between 0.01 per cent and 100 per

⁸ In fact, article 26-1 (II) of the SAFE requires that any retraction from liberalisation measures has to be approved by the Legislative Yüan in advance.

⁹ See Article 98 (I), 108 (II), 128 (I), 208 (V), and 216(I) of the Company Law. See also Chapter 7.2.2(B) above.

¹⁰ Article 98 of the Company Law.

cent of the total capital of the company. In addition, the non-FIA investors cannot be the ‘responsible persons’¹¹ of the company.

Secondly, non-FIA investors cannot enjoy the privileges of multi-entry visitor visas or multi-entry resident visas under the Key Points for Screening Applications for issuance of Multi-Entry Resident and Visitor Visas to Foreign Nationals.¹²

Thirdly, non-FIA investors cannot enjoy certain legal incentives which are used to encourage FIA investors to continue to hold 45 per cent or more of the total capital of the company, such as (1) a guarantee to investors that the company will not be subject to requisition or expropriation for a period of 20 years from the commencement of business; (2) possible exemption from the rules in Article 156 (IV) of the Company Law requiring issuance of stock certificates to the public; and (3) waiver of the rules in Article 267 of the Company Law that investors should set aside a certain percentage of new shares to be issued for purchase by the employees of the invested company.

Fourthly, FIA investors and FIA companies’ withholding tax is only 20 per cent (Article 11 of the SUI). However, if the investment does not get Government’s approval, withholding tax is set at 35 per cent (see Chapter 7.2.2 (A)).

Fifthly, overseas Chinese investors investing in FIA projects will qualify for privileges under Regulations Governing the Levy of Inheritance Tax on the Amount

¹¹ Article 8 of the Company Law defines the meaning of ‘responsible persons’ as follows: “... shareholders conducting the business or representing the company in case of an unlimited company or unlimited company with limited liability shareholders; directors of the company in case of a limited company or a company limited by shares. The managerial officer or liquidator of a company, the promoters, supervisor, inspector, reconstructor or reconstruction supervisor of a company limited by shares acting within the scope of their duties, are also responsible persons of a company.”

¹² Promulgated on April 12, 1984 by the Executive Yüan under its administration decree No. Tai (73) Wai 5496; it was amended on June 16, 1988, administration decree No. Tai (77) Wai 15831.

of Approved Investment by Overseas Chinese,¹³ under which half of the approved investment will be exempt from inheritance tax (Article 2). A non-FIA project will not receive such benefits.

9.2 Forms of Business Activity

The term “activity” is used here, instead of “organisation”, because the former is more inclusive. In particular, it allows the inclusion “activities” of foreign companies which cannot be classified as “foreign investment”.

Once an investor determines the method he will use to invest in the ROC, he must determine the form that the investment will take.

An individual foreign national or overseas Chinese can invest in Taiwan by purchasing shares in a ROC company or by establishing a ROC company with other investors (Wang, 1985: 513). A foreign corporate investor can, of course, also invest in Taiwan in either of these ways. However, if the corporation wishes to be actively represented in the ROC, establishing a company is not the only available method of representation. There are various forms of business activities in which a foreign company may consider operating in Taiwan, depending on the nature and range of its business involvement. The forms of business activity most frequently adopted by foreign investors are appointing an agent or a distributor, representative or liaison office, branch, or subsidiary. What follows is an assessment of the various forms and the legal problems they may involve.

¹³ Promulgated on November 29, 1979 by the Executive Yüan under its administration decree No. Tai (68) Ts'ai 11992.

9.2.1 Appointing An Agent or A Distributor

A foreign company may appoint an individual or a company in the ROC as its agent or distributor to conduct business on its behalf. A local company or a recognised branch office of a foreign company is entitled to act as agent or distributor on behalf of a foreign company. Article 558 (II) of the Civil Code stipulates that a business agent cannot subscribe to negotiable instruments or borrow fungible things or file an action in court, unless he has been given written authority to do so. In addition, according to Article 10 (II) of the Income Tax Law¹⁴, a business agent should fulfil any of the following requirements:

- “1. Where the agent, in addition to representing its principal in the purchase of goods, is authorised to regularly represent the principal in making business arrangements and in signing contracts;
2. Where the agent regularly keeps in store goods of its principal and delivers the same, for its principal, to others; or
3. Where the agent regularly accepts, for its principal, order for goods.”

The relationship between the foreign company and the agent or the distributor is only a contractual, fiduciary relationship. As such, it is governed by the relatively settled principles of law which apply to such relationships. From the perspective of corporate law, it is certainly the simplest form of business activity.

9.2.2 Representative or Liaison Office

Foreign investors may wish only to establish a presence without maintaining a significant profit-seeking operation in Taiwan. For investors merely desiring some market presence, the option to set up a representative or liaison office by appointing a person to act as its representative may be more suitable than setting up a branch or a subsidiary, because it requires much less cost and effort than those other methods.

¹⁴ The Income Tax Law was effective on February 17, 1943. During the past fifty-four years, it has been amended on twenty-nine occasions. The last amendment was made on January 27, 1995.

In general, there are two types of such offices: a representative office, which is set up according to Article 386 of the Company Law (so called '386 office'),¹⁵ and a liaison office which is set up simply by appointing a representative and filing the appointment letter with the local tax office for recording and tax registration purposes. Basically, a representative office and a liaison office are the same in terms of the scope of business activities allowed in the ROC. The difference is that a representative office is a form of organisation under the Company Law and a liaison office is not. Thus, a foreign investor wishing to set up a representative office must file an application with the central authority (i.e. Commerce Department of the MOEA). In contrast, if the foreign investor prefers to set up a liaison office, the investor only needs to file a business registration with the local tax collection authority for tax purposes.

The representative office of a foreign company cannot conduct profit-seeking business. It is permitted only to deal with legal matters as authorised by its parent company (ICID, 1996: 17). The representative office may engage in legal acts under the company name in Taiwan,¹⁶ such as signing contracts, negotiating prices, and bidding, and it may conduct other activities such as market surveys and product inspection. Such an office is ideal for a company which conducts only purchasing activities in the ROC. All matters in relation to the purchasing, such as locating suppliers, inspecting merchandise, and arranging shipping schedules can be handled by this office. Registration of the office requires only that there be a resident representative, either a domiciled national or a resident alien (Article 386 of the Company Law). The foreign company should file an application for

¹⁵ Article 386 of the Company Law: "A foreign company which, having no intention to set up a branch office to transact business within the territory of the ROC has not applied for recognition in the ROC, but designate a representative for the performance of juridical acts relating to its business in the territory of the ROC, shall file a report for record with the central authority setting forth the following particulars: ...".

¹⁶ The name of a foreign company must be translated into Chinese and also must indicate its nationality (Article 370 of the Company Law).

designation of the representative for record.¹⁷ Unlike a liaison office, running the representative office of a foreign company enables its representative to apply for a resident visa and alien resident certificate. (Note, however, that the enactment of the Employment Services Law in 1992¹⁸ has made it more difficult for foreign employees heading such offices to obtain resident status in Taiwan.¹⁹)

There are no capital contribution requirements for setting up a representative office. Because such an office does not engage in any profit-seeking business, the foreign company will not be subject to taxation in Taiwan. The office is also not liable for any tax on reimbursements of cost received from its head office, except that the office is required to withhold income tax on, for example, salaries to employees and rental payments to the landlord for office location. In addition, the representative office cannot use Government-issued unified invoices, because no profit-seeking business should be involved.

Like representative offices, a liaison office cannot sell goods or provide services in Taiwan. It can only act on behalf of its parent company for purchasing, inspecting merchandise, and liaison. All business and legal relationships of such an office must be conducted in the name of the individual acting as liaison person. A liaison office must file a business registration with the local tax collection authority, but may be exempted from business registration with other government authorities. The liaison office is also non-taxable. However, if the liaison office has income from non-profit-seeking business, such income is subject to the business income tax

¹⁷ Article 386 (IV) of the Company Law.

¹⁸ The Employment Services Law was enacted on May 8, 1992, and the Profession Introduction Law was repealed on the same day.

¹⁹ Under the Employment Service Law, no foreign national is allowed to work in Taiwan unless he/she obtains a work permit applied for by the employer. Also, Article 43 of the same law has a positive list stating those kinds of work that foreign nationals are allowed to engage in.

in accordance with the Business Tax Law.²⁰ Whether a representative or a liaison office, the office is subject to the tax authority's verification of the proper establishment of accounting records and the receipt of inward remittances from the home office in order to fund its operation.

In recent years some Government agencies have requested the MOEA not to grant permission for foreign companies to set up a 386 office in Taiwan (Liu, 1994: 139-140). This is because that there have been a number of foreign companies apparently setting up representative offices in Taiwan which secretly engage in profit-seeking business. The illegal phenomenon may be blamed partially on an ambiguous provision in Article 386 of the Company Law. Article 386 (I) states that a representative office of a foreign company in Taiwan is available for a foreign company "having no intention to ... transact business" in Taiwan. The question is, what exactly does the term "transact business" signify? Is contracting or bidding part of a business transaction? The law does not give a clear answer, and therefore a foreign companies would normally choose not to set up a branch or subsidiary in Taiwan "unless it is absolutely necessary."²¹ They prefer, instead, to rely on the ambiguity inherent in Article 386 of the Company Law and to establish representative or liaison offices.

9.2.3 Branch

A branch office, compared to a subsidiary, is the less complicated business form to create as it is not a ROC company; it is merely an extension of the foreign company. Therefore, a branch office need not comply with many of the regulations governing ROC companies. Instead, it needs only to comply with Chapter 7 of the Company Law, the section of the Law dealing with foreign companies.

²⁰ The Business Tax Law was effective on June 13, 1931, and has been amended for sixteen times till now. The last amendment was on July 30, 1993.

²¹ Interview with Cheng-li Huang, associate professor in Tamkang University, on July 28, 1996.

According to Article 371, a foreign company that wishes to set up a branch office in Taiwan must first be authorised to do business as a corporation in its own country. Then the company must undergo the recognition process with the Commercial Division of the MOEA in order to obtain a certificate of recognition.²² It must then register with the local Government Bureau of Construction of local government for issuance of a licence to do business in Taiwan (IDIC, 1996: 19). A foreign company which obtains a certificate of registration will have the same rights and obligations as a domestic company, and will be subject to the authority of the ROC government in the same manner as is a domestic company (Article 375). Finally, there is a modest capital contribution requirement in establishing a branch office. The foreign company must establish an appropriate fund for the exclusive use of this branch as its 'operating capital', which is similar to the paid-in capital of a company limited by shares. The amount of this fund will depend on the business of the foreign company (Article 372).²³ As such, the branch will have to set up its own accounting and book-keeping system and will be liable for all taxes applicable to local profit-seeking enterprises (Article 41 of the Income Tax Law). The Law does not regulate the nationality of the branch's responsible persons but states that the representative of the branch "should be within the territory of the ROC" (Article 372 (II)). The branch manager can therefore be either a domiciled national or a resident alien.

A branch office of a foreign company in the ROC can conduct the full range of business activities. Under ROC law, the Taiwan branch of a foreign company is not a separate legal entity (except for the purposes of the Income Tax Law) but an

²² For the nature and effect of the recognition of foreign companies, see Liu (1974: 282-284). It must be added that the ROC Company Law adopts the principle of reciprocity, and recognition may be denied to a foreign company if the country to which it belongs denies recognition to ROC companies (Article 373 (II) of the Company Law).

²³ If the foreign company is of the same nature as a 'company limited by shares' (discussed *infra*), the business capital requirement is NT\$ 1 million.

integral part of its parent company. This is the major disadvantage of the branch office. If its liabilities exceed its appropriated funds, the parent company is liable for the deficit. In other words, the parent company is jointly liable for all obligations and losses of the branch incurred in Taiwan and would be subject to the jurisdiction of the ROC authorities in litigation and non-litigation matters. Indeed, the branch manager of a foreign company in Taiwan often serves as the agent for service of process against the parent company for both litigious and non-litigious matters in Taiwan (Article 372).

This form of business organisation has been used most commonly in the banking and insurance industries, futures and securities trading, general trading, and trade-related services (Liu, 1994: 139). However, investments in those industries will not be able to get FIA approval. Furthermore, unless approved by the Investment Commission of MOEA, according to Article 6 of the SIFN, a branch company is not allowed to undertake any production or manufacturing. In practice, this leads to some simplification: the foreign investors do not need to proceed with the investment review process under the SIFN if they do not wish to set up a manufacturing or production branch. However, in certain regulated industries such as banking and insurance, because they fall into the categories of restricted industries in the Negative List, separate approval by the relevant agencies such as the Ministry of Finance must still be obtained in advance.

9.2.4 Subsidiary

A subsidiary, regardless of its dependent status with respect to management of its business affairs, is nevertheless a legally independent entity (Article 1 of the Company Law).²⁴ It is capable of dealing with third parties, and can be a

²⁴ See also *Wei Tseng Enterprise Inc. v. Taipei Tax Collection Office* Case, Administrative Court decision with reference number of 68-P'an-tzu-64, dated February 20, 1979, from *Gazette of Presidential Office* No. 3516, p. 9-10.

contractual debtor.²⁵ A subsidiary is responsible for tortious acts committed by its employees, and can be a tortious debtor (Article 23 of the Company Law).

Although a foreign investor may invest in any form of business enterprise, in most cases a foreign investor will want to participate in an organisation which is a separate legal entity. This separation of capacities has some advantages. For example, the life of the juridical entity is perpetual, unless specifically limited by its articles of incorporation.²⁶ This accords an element of continuity to the investment (Wang, 1985: 522). In addition, a juridical entity has legal capacities; it may hold property in its own name, sue and be sued, and become a party to a contract (Articles 25, 26 of the Civil Code). Furthermore, because a subsidiary has the character of an independent legal entity, the debts, obligations, and losses of a subsidiary will not normally be actionable against its parent company.²⁷ This insulation against losses make the subsidiary form a particularly useful vehicle for speculative ventures.

(A) A Wholly-Owned Subsidiary

The best means for a foreign investor to assure control over its overseas operation is, of course, to own it. However, because of restrictions in the ROC Company Law, it is not possible for foreign nationals or overseas Chinese to form a wholly-owned subsidiary in Taiwan, unless the investment is an FIA project.

²⁵ For detail, see Supreme Court decision, reference no. 59 T'ai-sung-tzu 4355, dated December 18, 1970 in Compilation of Republic of China Cases (1973, vol. 12: 515).

²⁶ There exists no provision which limit the life of a company. Therefore, it is assumed that unless otherwise provided for in the articles of incorporation, the life is perpetual.

²⁷ See *China Credit Information Service v. Taipei Bureau of National Taxation Case* (1973). Administrative court decision with reference number of 62-P'an-tzu-252, dated June 19, 1973, from Compilation of Republic of China Cases on Tax and Customs Cases (1975: 710). The Court stated that a parent company is not liable for the debts owed by its wholly-owned subsidiary.

Articles 98 (I) and 128 (I) of the Company Law stipulate that one-half of the shareholders in a limited company and founders of a company limited by shares should be domiciled in the ROC.²⁸ Compared to a company limited by shares, the limitations for establishing a limited company are even stricter in terms of Chinese nationality and the amount of the investment required. For example, one-half of the shareholders must be of Chinese Nationality and the total amount of their contribution must exceed 50 per cent of the total amount of capital of the company (Article 98). Furthermore, the director who represents the limited company externally must be of Chinese nationality and should be domiciled in the ROC (Article 108 (II)). However, there are also further limitations upon a company limited by shares. For example, the Chairman of the Board of Directors and the Vice Chairman must have Chinese nationality and, be domiciled within the territory of the ROC, and more than one-half of the managing directors and at least one of the ‘supervisors’²⁹ of a company must have be domiciled within the territory of the ROC (Article 208 (V) and Article 216 (I)).

In order to encourage FDI in preferred industries, all the above restrictions concerning domicile in ROC territory, Chinese nationality, and the amount of the investment may be waived if the investment project is approved by the Government (Article 18 of the SIFN and SIOC). In other words, through the FIA route it is possible for foreign nationals and overseas Chinese to form a wholly-owned subsidiary in Taiwan, where the investors can also be the responsible persons of the company.

²⁸ Under the ROC Company Law, a limited company shall have at least five and no more than twenty-one shareholders whereas a company limited by shares shall have at least seven promoters.

²⁹ The ‘supervisors’ of a company must be elected at a meeting of shareholders from among the shareholders (Article 216 of the Company Law). The supervisors may at any time investigate the business and financial condition of the company, examine books, records and documents and request the Board of directors to make reports (Article 218 of the Company Law).

(B) A Joint Venture Company

The Government has shown a preference for investments which combine foreign and local capital when granting approval of foreign investment applications (CDN, 30 December, 1995). It believes that certain local industries should be protected from the competition of foreign capital, management, and technical know-how, and should be either totally or, if not, at least partially owned by local investors (Hsu, Li, and Wang, 1985: 557). Of course, which industries are felt to deserve such protection changes from time to time, according to circumstances. However, over-emphasised protectionism in any country's FDI policy can not only deter the inflow of FDI but can also become an impediment to industrial upgrading.

The Government's policy has, of course, affected foreign investors. Many foreign investors in Taiwan have chosen to invest jointly with local capital and it appears that over 75 per cent of FIA investment in recent years has involved joint ventures (MOEA, Statistics, 1996).³⁰

(i) What Constitutes a Joint Venture?

In order to examine the legal status of a company which involves local and foreign capital, we first have to discuss what constitutes a joint venture. Unfortunately, there is neither a provision in ROC law nor a court decision that has attempted to define the term 'joint venture' (Hsu, Li and Wang, 1985: 561). Legal

³⁰ Historically, FDI in developing countries has generally been in the form of wholly-owned subsidiaries. In later years, however, there has been a tendency for foreign investors to share ownership with local investors (Harrigan, 1985). Apart from the reason that developing countries may pass legislation either prohibiting total foreign ownership or making incentives conditional upon a certain degree of local ownership, the most important factor has been that many foreign investors have become increasingly aware of the positive advantages they can derive from sharing ownership with local partners, whether private or governmental. Among these benefits are tangible contributions, such as land, capital, trained personnel, a knowledge of the local language, and familiarity with local markets, suppliers, and conditions of doing business. Some intangible benefits include the goodwill engendered with employees, customers and the Government, and the decreased likelihood of nationalisation or discriminatory legislation (UNIDO, 1971: 1; Beamish, 1988: 1; OECD, 1992: 8-9)

scholars³¹ and international organisations, such as the OECD³² and the European Commission of the EU³³ have made efforts to define the term. However, it is difficult to give a universally acceptable definition of this term because the concept of joint venture covers a large variety of situations, owing both to the diversity of actors and possible legal forms and to the fields, types of activity and objectives that are aimed at (OECD, 1986: 11; Way, 1994: 3; Ashurst, 1991: 1).

In determining the existence of a joint venture under ROC law, the following criteria are of vital importance:

(1) *A joint venture agreement.* Such an agreement constitutes a partnership among the joint venturers, and is a “voluntary contractual arrangement that goes beyond

³¹ For example, many lawyers (Faull, 1984: 358; Claydon, 1986: 151; Bellamy, Child and Rose, 1993: 193-194) have adopted the proposal of Brodley (1982: 1523-1526) and have defined joint venture as, “an integration of operations between two or more separate firms in which the following conditions are present: (i) The joint venture is under the joint control of the parent firms, which are not under related control; (ii) Each parent makes a substantial contribution to the joint venture; (iii) The joint venture exists as a business entity separate from its parents; (iv) The joint venture creates significant new enterprise capability in terms of new productive capacity, new technology, a new product or entity ...”

³² The OECD (1986: 11) gave the term joint venture a functional definition as involving: “the operations of two or more firms [which] are partially, but not fully, functionally integrated in order to carry out activities in one or more of the following areas: (i) Buying or selling operations; (ii) Natural resource exploration, development and/or production operations; (iii) Research and development operations; (iv) Engineering and construction operations”.

³³ In 1990, the European Commission of the EU defined ‘joint ventures’ as “undertakings that are jointly controlled by several other undertakings, the parent companies” (Commission Notice on Concentrative and Co-operative Operations, 1990: para. 7). Implicit in this definition are two issues: first, whether the relevant organisation or activity constitutes an undertaking and, secondly, whether the parties jointly control the undertaking (Fine, 1994: 287). The Commission has stressed that the legal form of the joint venture is irrelevant (Comm’n, Sixth Report on Competition Policy, 1977, point 54) and the definition does not require that it be intended and able to operate on a long-term basis (Commission Notice on Co-operative Joint Ventures, 1993: para. 10). Furthermore, the Commission has stated that “control means the possibility of exercising directly or indirectly, a decisive influence on the activities of the joint venture” (Commission Notice on Concentrative and Co-operative Operations, 1990: para. 9) and joint control would fail to exist only where “one of the parent companies can decide alone on the joint venture’s commercial activities” (Commission Notice on Concentrative and Co-operative Operations, 1990: para. 12). In 1974, the Commission defined a joint venture as “an enterprise subject to joint control by two or more undertakings which are economically independent of each other” (Comm’n, Fourth Report on Competition Policy, 1975: point 73; Comm’n, Thirteenth Report on Competition Policy, 1984: point 53).

being a mere contract” (Bean, 1995: 6), since the joint venture agreement also serves as a prerequisite for forming a joint venture corporation. More than a mere accord, the joint venture agreement is “a form and method of business organisation and of doing business” (Taubman, 1956: 643).

(2) *Dual interest*. In a joint venture arrangement, there should be a clear understanding concerning the existence of joint interest, as well as the sharing of profits and losses.

(3) *Degree of control*. There should also be a specific arrangement as to what degree of control each joint venturer will possess.

(4) *Fiduciary duty*: A fiduciary relationship³⁴ exists between joint venturers, who owe each other a duty of loyalty.

As a result, one can say that a joint venture also exists as a partnership relationship during the period before the incorporation of the joint venture enterprise.

Although it is established that a joint venture always commences pursuant to the conclusion of a joint venture agreement, it has frequently been questioned whether the agreement that gives the joint venture its existence automatically terminates when the enterprise is incorporated. For example, it is unclear whether the joint venture agreement terminates when the incorporation was for the purpose of carrying out the joint venture, if the rights of the third parties were not affected thereby, and the act of forming the corporation has been undertaken in conformity with the contractual agreements of the parties to the undertakings.

³⁴ “The recognition of fiduciary relationships and duties... is problematic and controversial because there is no agreed basis by which fiduciary relationships and duties may be recognised. Nor is there an all-embracing definition of a fiduciary relationship” (Bean, 1995: 24). One might say that a fiduciary relationship is a relationship in which fiduciary duties exist.

The ROC statutes do not give a clear answer. Article 667 (I) of the Book of Obligations of the ROC Civil Code states that the “partnership is a contract whereby two or more persons agree to put contributions in common for a collective enterprise”. The question then is can a “partnership”, as defined by the Civil Code, co-exist with one of the entities provided in the Company Law? As there is no restriction in ROC law prohibiting shareholders or directors from continuing or reaching an agreement among themselves, it seems reasonable to assume that if the parties to the agreement intended that the original contract would continue after incorporation, there should be no reason why the corporate form and the joint venture agreement cannot co-exist.

The above view fits well with the reality of business practice. The establishment and registration of a company often involves various types of contractual relationships among the promoters, shareholders, and directors; such contractual relationships cannot be terminated simply because the joint venture has entered a new phase, namely, the incorporation of a joint venture company. Instead, the situation should be viewed as one where, before incorporation, all juridical acts are conducted in the name of a partnership; all partners bear *inter se* obligations as joint and several obligators. Then, once the joint venture company is incorporated, the joint venture agreement may still be in effect, even though all juridical acts are concluded in the name of the company. If the company is of limited liability, liability will then be limited to the assets of the company.

(ii) Corporate Structure of Joint Ventures

As stated above, the term ‘joint venture’ has been used quite loosely. The mere existence of a joint venture agreement and of share participation, regardless of the percentage of shares, would be considered a joint venture in most cases. Any one of the four different forms of companies under the ROC Company Law may be chosen for a joint venture operation; there is no law restricting joint ventures

involving foreign investors. For the investor who wishes to obtain the privileges afforded by the SIFN or SIOC, such as repatriation of earnings and capital, these Statutes do not limit the forms of business organisations that can take advantage of the provisions.

Nevertheless, as most investors are anxious not to expose themselves to unnecessary liability, normally the only reasonable investment choices are the limited company and the company limited by shares.³⁵ From the viewpoint of the Company Law, the most satisfactory form of organisation for a joint venture is probably the 'limited company'. This is because (1) the liability of shareholders is limited to the extent of the capital each contributes (Article 98); (2) shareholders who do not conduct business may, from time to time, exercise a power of control (Article 109); (3) a shareholder may not, without the agreement of a majority of the other shareholders, transfer all or a part of his shareholding in the company to another person (Article 111); and (4) as a further measure to maintain the closed nature of the enterprise and to preserve management interest, the directors may not transfer any part of their capital contribution to a third party without the unanimous consent of all the other shareholders (Article 111).

Such an internal corporate arrangement greatly simplifies the complicated nature of a joint venture and, under normal circumstances, would be a satisfactory vehicle for a joint venture company. In practice, it is also easier for a joint venture company with relatively few venturers and a small amount of capital to form a limited company in Taiwan. Article 98 of the Company Law states that a limited company must have at least five but no more than twenty-one shareholders,

³⁵ Before the SEI expired in December 1990, a limited company could not take advantage of the privileges and benefits provided by the SEI; only a "company limited by shares" was recognised as a "productive enterprise" entitled to the Statute's preferential treatment (Article 3 of SEI). As a result, many foreign investors chose to use a company limited by shares as the vehicle for their Taiwan operations. After the Government's 1990 FDI law reform (SEI repealed in 1990), no such restrictions exist under the SUI.

whereas a company limited by shares must have at least seven founders (Article 128). In addition, the minimum total capital of a limited company is NT\$ 500,000, while it is NT\$ 1 million for a company limited by shares.³⁶

Compared to a limited company, establishing a company limited by shares involves more complex legal constraints. For example, when the capital of the latter has reached or exceeded a specific amount fixed by the central authority, its share certificates must be issued in public (Article 156 (IV)). In addition, it is a form of business organisation which incorporates all the features of limited liability and centralised management, as well as with the added possibility of public solicitation of shares to raise additional capital (Article 2 and 133) - with all the securities regulation that doing so involves. Some quite particular rules also apply, and are often relevant to FDI ventures. For example, a foreign or local investor who wishes to use patent rights or technical know-how as a contribution to capital must be a promoter (Article 131 and 156 (V)). Patent rights are limited to 20 per cent of the total capital, whereas technical know-how is limited to 15 per cent.³⁷ Article 156 (V) of the Company Law also states that contributions made by shareholders must be in cash, but that promoters may make payment for shares in assets which are required for the business of the company (Article 131 and 156).

(iii) An Ordinary Local Company

If a foreign national or overseas Chinese fails to qualify for investment under the SIFN or SIOC he may still organise an ordinary local company jointly with local nationals, but will not be able to hold a majority share in it. The company will be treated as a 'normal' local company; thus the restrictions in Articles 98, 108,

³⁶ For details, see Article 2 of The Standard Regarding the Minimum Total Capital For a Limited Company or a Company Limited By Shares, promulgated on October 15, 1980 and then revised on June 29, 1988.

³⁷ See Article 6 of the Regulations Governing the Use of Patent Rights and Technical Know-How As Equity Investment. It was promulgated on June 3, 1968.

128, 208, and 216 of the ROC Company Law regarding local residence, nationality, and maximum investment amount of the company capital will bind the investors. In practice, there are some joint venture companies operating in Taiwan that have never applied for the privileges conferred under the SIFN or SIOC. Such companies operate as any local company would, with no privileges.

(iv) An Foreign Investment Approved Company

A subsidiary of a foreign company setting up in the ROC is considered an independent juridical person, and must apply to the Investment Commission of Ministry of Economic Affairs in accordance with the SIFN and the Company Law. As long as the foreign national or overseas Chinese investor establishes new enterprises under the SIFN or SIOC and obtains approval from the Investment Commission, those investors are eligible to enjoy a number of benefits mentioned in Chapter 9.1.1 earlier. For example, they may be exempt from the restrictions concerning domicile in the ROC territory, ROC nationality, and amount of investment contained in Articles 98(I), 108(II), 128(I), 208(V) and 216(I) of the Company Law, regardless of the form of the company used.

Chapter 10

Prerequisites for the Admission of Foreign Investments in the ROC¹

For FDI to be admitted into Taiwan under the present ROC laws, there are certain substantive and procedural requirements which have to be satisfied initially. Once these requirements have been met, an investor will be entitled to claim those measures of protection which will be discussed in the next chapter, and may also benefit from certain incentives. In the previous chapter, we discussed the requirements for FIA investment and the limitations on non-FIA investment in Taiwan and analysed the forms of business organisation which operate those investment activities. This chapter will focus on the initial question of the definition of the term 'foreign direct investment', both under the ROC investment laws and bilateral treaties. In addition, legal issues regarding entry visa, resident and work permits are important as they fall into the category of prerequisites for the admission of investments and will therefore be discussed in this chapter. In the course of the chapter, aspects of present ROC laws regarding the admission of investments will be criticised, and some suggestions for possible legal reforms will be made.

¹ To translate the relevant legal texts from Chinese to English is not an easy task. Although many administrative authorities have English translations of the laws and/or regulations for which they are responsible, no official and authoritative translation of the laws of the ROC has been available, as mentioned in a meeting of the Judicial Yüan held in April 1991. In this research, all the translations of Constitution Law and the Nationality Law texts are based on the Major Statutes of the Republic of China, (1990 and 1992) Vol. 1-2, published by the Judicial Yüan. The translation of Civil Law texts is based on the Major Laws of the Republic of China on Taiwan, (1991) published by the Magnificent Publishing Co.

10.1 The Concept of Foreign Direct Investment

As defined in Chapter 1, this research is concerned only with foreign private direct investment. Such investments normally involve three parties: the capital-importing country, the foreign investors, and the capital-exporting countries (of which the foreign investors are usually nationals). As a result, the legal problems of FDI are more complicated than that of foreign public investment because the latter transaction involves only two parties: the capital-importing and capital-exporting countries or institutions. In addition, FDI involves the “movement of persons and property from one state to another and such movements have potential for conflict between the two states” (Sonarajah, 1994: 7-8). Because of the complex nature of FDI, it is helpful to consider the definitions of FDI formulated by scholars before clarifying the definition of FDI both in the context of international instruments and under the ROC laws.

Although many investment lawyers have attempted to define FDI, there is no internationally-accepted definition of the term. However, it appears that many scholars have stressed the importance of ‘control’ in their FDI definitions. Graham and Krugman (1995), for example, have claimed that “foreign direct investment is formally defined as ownership of assets by foreign residents for purpose of controlling the use of those assets.” Sonarajah (1994: 4), has also argued that FDI “involves the transfer of tangible or intangible assets from one country into another for the purpose of use in that country to generate wealth under the total or partial control of the owner of the assets.” Oman (1995: 73) emphasised that FDI “is defined as investment by non-residents who ... have an effective voice in the management of the enterprise in which they are investing”.

The emphasis on control, taking the form of influence upon management of the investment, is also found in definitions of the term offered by international

organisations, such as the OECD and the World Bank. For example, the OECD (1996b: 7-8) has stated that:

“FDI reflects the objective of obtaining a lasting interest by a resident entity in one economy (‘direct investor’) in an entity resident in an economy other than that of the investor (‘direct investment enterprise’). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.”²

The World Bank (1996: xvi) has defined FDI in a comparable manner.³

Unfortunately, no corresponding definition of FDI can be found in the ROC laws. Even the SIFN and SIOC, two major laws governing the investments made respectively by foreign nationals and overseas Chinese, only regulate the methods of FDI and fail to define the term. Although the term ‘FDI’ has been defined earlier in Chapter 1 as “the phenomenon of non-governmental long-term assets movement” and “the word ‘direct’ not only means the foreigner invests in a business in the host country but also that he controls that business”, these definitions serve only the purposes of the context in which they appear in this thesis, and are by no means general in application.

It is worth remarking that the term ‘*ch’iao-wai chih-chieh-t’ou-tzu*’ in the ROC means not only investments made directly by foreign nationals but also by overseas Chinese.⁴ Therefore, there are three components even in the concept of

² The OECD Benchmark Definition states that it “is fully consistent with the IMF *Balance of Payments Manual* (1993)” (OECD, 1996b: 3).

³ The World Bank (1996: xvi) has defined FDI as “investment that is made to acquire a lasting management interest (usually 10 per cent of voting stock) in an enterprise operating in a country other than that of the investor (defined according to residency), the investor’s purpose being an effective voice in the management of the enterprise. It is the sum of equity capital reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments.”

⁴ The ROC is not the only example of this phenomenon in the world. Spaniards or Nicaraguans who habitually and permanently reside abroad are also considered as ‘foreigners’ for the purposes of Spanish and Nicaraguan investment legislation. For details of the Spanish investment laws,

foreign investment in Taiwan, namely, the ‘foreign nationals’, the ‘overseas Chinese’, and the ‘investment’. Many legal questions follow. What is the definition of foreign nationals? Can a ROC citizen with a dual nationality also enjoy the privileges in the SIFN? What are the criteria applied by the ROC legislation in determining whether juridical persons such as companies are nationals or foreigners? How does the ROC law distinguish between private juridical persons and public juridical persons? What is the definition of overseas Chinese? Can overseas juridical Chinese qualify under the SIOC? What is the definition of investment under the ROC law? This section is aimed at answering the above questions.

10.1.1 Foreign Nationals

The SIFN states that it governs matters relating to investments by foreign nationals (Article 1). However, it does not define foreign nationals and only stipulates that ‘foreign nationals’ include foreign natural and juridical persons (Article 2 (I)). One can therefore assume that investments are defined as foreign in Taiwan according to the nationality of investors rather than according to the foreign origin of capital brought in by such investors.

(A) Foreign Natural Persons

It is an accepted view, under customary international law, that it is for each state to decide who has its nationality.⁵ Whether it decides the problem of

see Spanish Decree Liberalisation Procedures for Foreign Majority Ownership of Certain Investments, Decree-Law No. 701/1963, 18 April 1963 (Gracés, 1976: 15- 22; 2 *I.L.M.*, 1963: 676-677); for details of Nicaragua’s investment laws, see Article 1, Decree No. 10, 1935 (Don, 1979: 17).

⁵ Manley O. Hudson (*U.N.Y.B.I.L.C.*, 1952: ii.3- 7) expressed his view as a Special Rapporteur in the International Law Commission that “In principle, questions of nationality fall within the domestic jurisdiction of each state”. Cf. *United States v. Wong Kim Ark* 169 U.S. 649 (1898); Whiteman (1967, vol. 8: 121). There is much literature on the concept of nationality in international law, for example Oppenheim (1996: 869); Shearer (1994: 307); Shaw (1991:

nationality in accordance with its constitution or other municipal laws is of no concern to international law. This principal was confirmed by the Permanent Court of International Justice (PCIJ) in its *Advisory Opinion in the Nationality Decrees in Tunis and Morocco Case* (1923).⁶ The Court stated:

“Thus, in the present state of international law, questions of nationality are ..., in principle, within the reserved domain [of a State’s domestic jurisdiction]”.

The ROC has followed this practice in the investment agreements it has concluded with other countries. The Agreement between the Government of the Republic of China and the Government of Republic of Panama for Treatment and Protection of Investments (cited hereinafter as the ROC-Panama Investment Protection Agreement), 1992,⁷ defined the term ‘nationals’ in Article 1 as:

“natural persons who, according to the respective legislation of each contracting party, have nationality or citizenship of that country.”

404); Brownlie (1996: 381); Parry (1957: 4); MacDougal (1974: 981); Amerasinghe (1977: 246).

⁶ *P.C.I.J. Series B, No. 4, 1923: 24; W.C.R. (1969: 145-162); [1923- 1924] 2 Annual Digest, case 203, pp. 349- 355. However, although conferment of nationality is decided by the state in accordance with its municipal law, the state’s right of granting nationality is not unlimited. Article 1 of the 1930 Hague Convention on the Conflict of Nationality Laws provided: “it is for each state to determine under its own law who are its nationals. The law shall be recognised by other states in so far as it is consistent with international conventions, international custom and the principles of law generally recognised with regard to nationality”. In addition, the determination made by each state regarding nationality is not always to be accepted internationally. In the *Nottebohm Case (Second Phase)* the International Court of Justice stated: “A State cannot claim that the rules [pertaining to the acquisition of nationality] which it has thus laid down are entitled to recognition by another State unless it has acted in conformity with this general aim of making the legal bond of nationality accord with the individual’s genuine connection with the State which assumes the defence of its citizens by means of protection as against other State.” (*I.C.J. Reports, 1955: 23*) The Court then defined nationality as: “a legal bond as its basis a social fact of attachment, a genuine connection of existence and sentiments, together with the existence of reciprocal rights and duties” (*I.C.J. Reports, 1955: 4, 23*). It is important to note that the International Court of Justice did not exclude the possibility that international law may limit a state’s freedom on granting its own nationality according to its own laws, but it was not necessary to decide the point in that particular case (*I.C.J. Reports, 1955: 20*). For discussion about this case, see Jones (1956: 230-244) ; Kunz (1960: 324- 347); Weis (1979: 176-181).*

⁷ This agreement was signed on March 26, 1992 and came into effect on July 14, 1992. (TRFS, 1994: vol. 9, 207-216)

The same definition had been adopted in the Agreement between the Government of Republic of China and the Government of Nicaragua for Guarantee of Investments (cited hereinafter as the ROC-Nicaragua Investment Guarantee Agreement), 1992.⁸

In Taiwan, investments made by foreign nationals are deemed to be foreign investments whether the investor resides abroad or in Taiwan. However, unlike many other countries, such as the United States,⁹ Philippines¹⁰ and Kenya,¹¹ there is no comprehensive statutory definition for the terms ‘foreign national’ or ‘alien’ under the ROC laws. Thus, we can only infer the meaning of those terms by an indirect method. Article 3 of the ROC Constitution defines the citizens of the ROC as those who possess the nationality of the ROC. Presumably therefore, a non-citizen of the ROC shall be a person who has not acquired ROC nationality in accordance with the ROC nationality laws.

The question to decide now is whether or not the meaning of ‘non-citizens of the ROC’ is identical to the meaning of ‘foreign nationals’. The distinction between citizens and nationals (or subjects) still exists in many countries, including the United States¹² and the United Kingdom.¹³ In those countries, every citizen is a

⁸ This agreement was signed on July 29, 1992 and came into effect on January 8, 1993. (TRFS, 1994: vol. 9, 183-193)

⁹ Section 1101 of the U.S. Code, 1988 and Part 215.1, 8 CFR, 1993: “The term ‘alien’ means any person who is not a citizen or national of the United States” (Zagaris, 1980: 1; KPMG, 1991: 109).

¹⁰ Section 2 (e) and (f), Republic Act No. 5186, 1967.

¹¹ Article 2 (1), Foreign Investment Protection Act, No. 35, 1964: “‘foreign national’ means a person who is not a citizen of Kenya”.

¹² United States Immigration and Nationality Act, 1952. 8 *Public Law* 414--82nd Congress, 2nd Session, 66, Stat 163; section 308 is entitled “Nationals but not citizens of the United States at birth”. That the term ‘American national’ has a wider meaning than ‘United States citizen’ was recognised in *Administrative Decision No. V* (Nationality of Claims) of the Mixed Claims Commission of the case *United States v. Germany* (1924), [1923-1924] 2 *Annual Digest*, case

national (or subject), but not every national (or subject) is necessarily a citizen of the State. If this is also the case in Taiwan, then a non-citizen may claim rights and advantages under the SIFN as a national of the ROC.

ROC possesses a civil law system, and the underlying principles of its laws are therefore analogous with Continental European legal systems.¹⁴ In such States, nationality is “a membership of the State” (Salmond, 1901: 272), which “in itself is conceived of as a personal association or corporation of member-individuals” (Weis, 1974: 4). For common-law States with a feudal conception of nationality, including the United Kingdom, the status of ‘subject’ is the quality of the individual’s being subject to the Sovereign,¹⁵ and nationality is a territorially-determined relationship between subject and Sovereign (Weis, 1974: 4; Blackstone, 1859, vol. 1: 336-375; Koessler, 1946: 58-76; Van Pittius, 1930: 12-17; Stanbrook,

100, pp. 185- 189; Whiteman (1963, vol. 1: 5). See also on the distinction between nationality and citizenship, UN Juridical Y.B. (1980: 189-191).

¹³ There are about 50,000 people, according to the 1980 White Paper (Cmnd. 7987: 30), belonging to the category of ‘British subjects without citizenship’. The status of British subject without citizenship remains one of the loose ends in British nationality law which has not been tied up by the 1981 Act. For details, see Grant and Martin (1982: 27), Halsbury’s Law of England (1992: 64-66), Stanbrook (1982: 85- 86).

¹⁴ Modern Chinese law is the result of judicial reform which started at the beginning of the twentieth century when Western legal thought and institutions were imported into China. Basic laws, such as the Civil Code and Company Law, were codified in the 1920s and early 1930s, and in general followed the continental European system, particularly German and Swiss law. Therefore, as far as its basic concepts, principles, and institutions are concerned modern Chinese law and the modern Chinese legal system are similar to other legal systems influenced by the reception of Roman law (Ma, 1985: 2-17).

¹⁵ As early as in *Calvin’s Case* (1608) (7 Co Rep 1; [1603-1627] 2 S.T. 559-696), Lord Coke stated that “Whosoever are born under one natural ligeance and obedience, due by the law of nature to one sovereign, are natural-born subjects” (p. 24b) and “... actual obedience to the Sovereign at the time of the birth; ...” (p. 27a). See also *Isaacson v. Durant* (1886), [1886] 17 Q.B.D. 54-66; [1886] 55 L.J.R. 331-339; [1886] 54 L.T.R. 684-688. For more information about the relationship between the subject and Sovereign at common law system, see Van Pittius (1930: 14). Also cf. paragraph (1) section 4 of British Nationality Act 1981 (Statutes in Force, 87. Nationality; Halsbury Statutes, 1994: 127-196) and Halsbury’s Law of England (1992: 3-7).

1982: 85-88). However, probably the best view under international law is, offered by Oppenheim (1992: 856):

“In general, it matters not, as far as the international law is concerned, that a state’s internal laws may distinguish between different kinds of nationals - for instance, those who enjoy full political rights, and are on that account named citizens, and those who are less favoured, and are on that account not named citizens.”

Because the ROC adopts the idea that nationality means membership of the State, it uses the term ‘citizen’ as a synonym for national and does not use the term ‘subject’; the term ‘citizenship’ is used as a synonym for ‘nationality’.¹⁶ We can therefore conclude that the meaning of ‘non-citizens’ is identical to that of ‘foreign nationals’ in Taiwan. If a ROC citizen has a dual nationality, it is clear that he is not qualified to any benefits under the SIFN, since he is a citizen and by implication not a foreign national for the purpose of ROC law.

It is also interesting to note that the Convention on the Settlement of Investment Disputes between States and Nationals of Other States¹⁷ (hereinafter referred to as the ICSID Convention), which came into force on 14 October 1966, uses the concepts of ‘national’ and ‘foreign investment’ without giving further definitions.¹⁸ However, Article 25(2)(a) of the Convention prohibits an investor

¹⁶ The terms of ‘nationality’ and ‘citizenship’, conceptually and linguistically, emphasise actually two different aspect of the same notion - state membership. ‘Nationality’ stresses the international, ‘citizenship’ the national, municipal, aspect. (Weis, 1979: 4- 5). In other words, “Nationality is the delimitation of personal jurisdiction, while citizenship refers to the legal relationship of the citizen to the State” (Gargas, 1928: 6). However, Weis (1974: 4) and Salmond (1901: 270- 282) have referred to the derivation of the term ‘citizenship’ from the Latin *civis--civitas* and have claimed that as long as States apply a Roman law conception of nationality, citizenship may be used as a synonym for nationality.

¹⁷ 575 U.N.T.S. 159; 4 *I.L.M.* (1965: 532); U.K.T.S. (1967: No. 25) or Cmnd. 3255; 17 *United States Treaty Series* 1270; *Treaties and Other International Acts Series*, p. 6090; Centre document ICSID/2; 60 *A.J.I.L.* (1966: 892); *Investment Laws of the World*, vol. 1.

¹⁸ See Article 25(II)(a) of the ICSID Convention. Lack of definition of the crucial terms is not always considered a drawback. For example, Shihata (1988: 139) has stated that because the ICSID Convention does not include any definition of the term ‘investment’ it is, to that extent, more flexible than the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA Convention), 1985.

with dual nationality from making use of the jurisdiction of the Centre established by the convention if he holds the nationality of the State which is also a party to the investment dispute.¹⁹

(B) Foreign Juridical Persons

Juridical persons present rather more difficulties for FDI classification than national ones. For the purposes of diplomatic protection and international claims, it is important to discuss the traditional rules for attributing the nationality of a corporation to a state, and to examine (i) the criteria applied by the ROC legislation in determining whether juridical persons are nationals or foreigners; and (ii) if it is a foreign corporation, how the ROC determines its nationality.

The problem of the nationality of companies is an extremely complex one, and this complexity has given rise to a considerable body of legal literature.²⁰ In the present research, we are not concerned with the question whether juridical persons should be regarded as subject to the rights and obligations conferred by possessing the nationality of a state.²¹ Rather, given that most internal legislative systems, including the ROC, distinguish between national and foreign companies, it is of great practical interest to consider what different criteria can be applied in

¹⁹ Article 25 (2) (a) of the Convention has stipulated that ‘national of another Contracting State’ means: “any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered ..., but does not include any person who on either date also had the nationality of the Contracting State party to the dispute.”

²⁰ The International Court of Justice stated in the *Barcelona Traction* case: “In allocating corporate entities to States for purposes of diplomatic protection, international law is based, but only to a limited extent, on an analogy with the rules governing the nationality of individuals” (*I.C.J. Reports*, 1970: 42). See generally Seidl-Hohenveldern (1987: Chapter 2).

²¹ Article 26 of the ROC Civil Law: “A juridical person shall have the ability to enjoy, within the limits prescribed by law, all rights and obligations, except those that are peculiar to a natural person”.

attributing a specific nationality to a company; and, more particularly, what criteria ROC law has adopted to resolve this issue.

In general, there are a number of possible tests to determine the nationality of juridical persons: the decision of the contracting parties; the law of the place of incorporation;²² the law of the location of the seat of control of a company (*siège social*);²³ the nationality of the partners;²⁴ the nationality of the person who has effective control of the company (*siège control*);²⁵ the place of issue of the shares

²² The US and Commonwealth countries, generally, adopt the incorporation test. This test was applied by the International Court of Justice in the *Anglo-Iranian Oil Case (Preliminary Objection)*, where the Court expressly noted that the company was incorporated under the laws of the United Kingdom and then referred to it as “this British company” (*I.C.J. Reports*, 1952: 102). Also, Article 1 and 2 of the Hague Convention 1956 concerning the Recognition of the Legal Personality of Foreign Corporations, Partnerships and Foundations states that the possession of legal personality is determined by the law of the state under which the entity was established or by the law of the place where the entity has its real seat (*siège réel*). The same test was later applied by the International Court of Justice in the *Barcelona Traction, Light and Power Co. Case*. The Court held: “The traditional rule attributes the right of diplomatic protection of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office” (*I.C.J. Reports*, 1970: 42).

²³ Generally speaking, in civil law systems, the law of the location of the seat of control of a company determines its nationality. This test was acknowledged by the Permanent Court of International Justice in the *Wimbledon Case*, 1923 (*P.C.I.J. Reports*, Series A, No. 1), where the only relevant feature of the company that France was protecting was the location of its seat of control which, being in Paris, established the company’s nationality as French according to French law. Cf. Section 1 (d) of the Investment Code of Zaire which defines a resident juridical person as “any corporate body whose registered office or main establishment is in the Democratic Republic of the Congo” (O’Connell, 1970: 1041). Also, cf. the Indonesian Foreign Investment Law of 1967 provides “An enterprise ..., which is operated wholly or for the most part in Indonesia as an independent business unit, must be a legal entity according to Indonesian law and have its domicile in Indonesia” (*Investment Laws of the World*, vol. 3).

²⁴ For example, in English law, a partnership is not a separate legal entity; the partnership will fall to be protected according to the national interests of the partners (Oppenheim, 1996: 520). But in French law, partnership is an independent entity and has its own personality (Su, 1985: 185).

²⁵ This test was applied during the two World Wars by the British and American courts to decide the enemy character of companies (Mann, 1962: 471; Domke, 1950: 52). In other words, if a company is controlled by enemy nationals, it has enemy character even if it is not incorporated in a non-enemy state. Occasionally, the notion of control has been resorted to for the purpose of justifying protection of the alien shareholders of a company which is incorporated in the respondent State and has its ‘*siège control*’ or its domicile there (O’Connell, 1970: 1042). See the *I’m Alone Case* (1933, 1935) (3 *R.I.A.A.* 1609; 29 *A.J.I.L.* 1935: 326). In this case, the Commissioners did not deny Canada’s capacity to present the claim. However, it declined to award damages to Canada for an unlawful act committed by the US against property of a Canadian company (the *I’m Alone* was a British ship registered in Canada) in which all the

representing the company's capital; the nationality of the substantial economic interest owner;²⁶ the nationality of the ratifying authority; the situation of the centre of operation;²⁷ and the location of its registered office (Gracés, 1976: 23; O'Connell, 1970: 1040-1043; El Sheikh, 1984: 16-19; Brownlie, 1996: 421-424). In deciding which company acquires its nationality, domestic laws or treaties may apply one of these tests, or may combine two or even three of them together.²⁸

With regard to this question, the ROC legislative system reveals a certain degree of confusion, since the various provisions that refer to the nationality of juridical persons are not absolutely consistent with one another. For clarity, I will examine the criteria which the ROC laws have applied to decide the identity of

shareholders were Canadian, since the company held its property in trust for the benefit of certain US nationals. The Commissioners provided: "the *I'm Alone*, although a British ship of Canadian registry, was *de facto* owned, controlled, and at the critical times, managed, and her movements directed and her cargo dealt with and disposed of, by a group of persons acting in concert who were entirely, or nearly so, citizens of the United States, and who employed her for the purposes mentioned." "The Commissioners consider that, in view of the facts, no compensation ought to be paid in respect of the loss of the ship or the cargo."

²⁶ This test was adopted in Article 3 of the Convention establishing the UK-Mexican Claims Commission (11 U.K.T.S., 1928), covering claims against Mexico for damage suffered by "any partnership, company or association in which British subjects or persons under British protection have or have had an interest exceeding 50 per cent of the total capital"; and the US-Peru Claims Settlement Agreement 1974 (68 A.J.I.L., 1974: 583), which covered claims of companies organised under the US law and owned by US citizens 50 per cent or more of the outstanding stock or property interest; also the US-Bulgarian Claims Agreement, 1963; 58 A.J.I.L. (1964: 686); see also Article 9 (c) of the Draft Convention on the Protection of Foreign Property 1967, adopted within the framework of the OECD (7 I.L.M., 1968: 117). More recently, this test was applied by the International Court of Justice in the *Elettronica Sicula* case 1989, where a state (the US) whose nationals held a substantial interest in a foreign (Italian) company presented a claim for damage suffered by the company itself. (I.C.J. Reports, 1989: 15).

²⁷ This test is claimed by a French lawyer, Lyon Caën. For discussion, see Wolff (1950: 289-299); Rabel (1958, vol. 2: 33-68); Ma (1986: 162-165).

²⁸ For example, Article 63 of the Lomé Convention of 1975, concluded among the European community and the African-Caribbean-Pacific countries (A.C.P.), defines for its own purposes that the nationality of a company or a firm of a Member State or of an A.C.P. State is determined by blending together the tests of '*siège social*' and place of registration (incorporation), and it is not enough for the company or firm to acquire the nationality of a member or A.C.P. State by only having its registered office there (*The Courier* no. 31).

Chinese juridical persons, and then that of the foreign juridical persons. After discussing the state practice, the application of bilateral treaties will also be addressed.

Articles 25, 29, 30, 48(II), and 61(II) of the ROC Civil Law²⁹ give official sanction to the double criteria of incorporation and *siège social* tests by indicating two requirements that must be fulfilled by a juridical person in order to be validly constituted under domestic law: incorporation in accordance with the law of the ROC, and having its principal office within the national territory. If a company meets these tests, it is treated by the Civil Law as having Chinese nationality. We can conclude therefore that ROC law uses the incorporation and *siège social* tests in order to distinguish national from foreign juridical persons.

However, Article 2 of the *Law Governing the Application of Laws to Civil Matters Involving Foreign Elements* provides:³⁰ “With respect to a foreign juridical person who comes into existence under the authorisation of the Republic of China, the *lex domicilii* of such juridical person shall apply *as the law of his country*”.

²⁹ Article 25: “No juridical person may be formed unless it is incorporated in accordance with the Civil Law or other regulations”.

Article 29: “The domicile of a juridical person is the location of its principal administrative office.”

Article 30: “No juridical person may be formed until it has completed registration with the competent authority.”

Article 48 (II) of the Civil Law: “The application for the registration of an association shall be submitted by the directors to the competent authorities for the places where its principal and branch offices are located. A copy of its constitution shall be annexed to the petition for registration.”

Article 61 (II) of the Civil Law: “The foundation shall be registered by the directors with the competent authorities for the principal office and branch offices. A copy of the act of endowment or the will must be annexed to the application for registration.”

³⁰ The *Law Governing the Application of Laws to Civil Matters Involving Foreign Elements* was promulgated and enforced on June 6, 1953.

Thus it appears that the law adopts only the *siège social* test to decide the particular nationality of foreign juridical persons. While this appears similar to the Chinese nationality test, it is not quite the same. And there is further possible conflict among the other relevant ROC laws regarding this question.

Article 2 (II) of the SIFN states that the nationality of a foreign juridical person shall be “determined by the law under which such a foreign juridical person is incorporated”. Article 4 of the Company Law describes the term ‘foreign company’ as “a company, for the purpose of profit making, organised, incorporated and registered in accordance with the laws of a foreign country, and authorised by the Chinese Government to transact business within the territory of the Republic of China”.³¹ It is obvious that the regulations here adopt the incorporation test: the nationality of a juridical person is determined according to the law of the country in which it is incorporated.

From the above discussion, it is clear that there is lack of legal consistency among the ROC regulations regarding how to determine the nationality of juridical persons. It is difficult to conclude which criteria the ROC laws adopt: Although the general Civil Law suggests the twofold test of incorporation and *siège social* to determine the nationality of foreign juridical persons, the SIFN and the Law Governing the Application of Laws to Civil Matters Involving Foreign Elements are statutes which are both more specific in their application to Company Law, and more recent in their enactment. This, in accordance with the general principles of *lex specialis derogat legi generali* and *lex posterior derogat priori*, suggests that the incorporation test may be preferred to determine the nationality of juridical

³¹ Article 4 of the Company Law: “For the purposes of this Law, the term ‘foreign company’ used herein shall denote a company duly organised under the laws of a foreign country for the purpose of seeking profit, and duly recognised by the Government of the ROC to transact business within the territory of the ROC.”

persons. In short, this is a question which worth more attention for scholars and needs to be clarified by the legislators.³²

In practice, the particular nationality of the foreign investor rarely presents problems for the government agencies when reviewing an investment application (Liu, 1994: 140). Then, one may ask, why it is important to clarify the legal criteria for determining the nationality of juridical persons? There are at least two reasons.

First, traditionally, investment made by Hong Kong individuals and corporations has received more scrutiny and therefore requires more time for completion of the FIA review.³³ This is because the ROC government is concerned about possible infiltration by mainland China and about security risks arising from such investments.³⁴ If the ROC uses the incorporation or *siège social* tests, it cannot thereby solve this problem, since these tests will not necessarily reveal the nationality of the controlling individuals or major investors.

Secondly, it is not clear whether a foreign juridical person needs to have a principal office abroad under the ROC laws. There is no express provision to this effect in the ROC Company Law, 1990, nor in the SIFN, 1989. The difficulty with

³² A point that has been made by a number of Taiwanese lawyers. See Tsen-chen (1984: 2- 6); Mei (1990: 174- 181); Lu (1988: 119- 123); Ma (1986: 161- 165); Ke (1987: 717-718).

³³ Since July 1, 1997, those Hong Kong citizens who do not have Overseas Chinese Identification Cards no longer possess overseas Chinese status in Taiwan, which confers the right to work, buy real estate, and hold full civil rights in Taiwan (July 1, 1997, *The China News*).

³⁴ Like Korea, China is one of the so called 'divided countries'. The special political situation is reflected in the ROC investment laws. The Nationalist Chinese Government in Taiwan changed its requirements relating to foreign investors in order to cope with the diplomatic upheaval which was caused by the Peking Government's taking over of the 'China seat' at the United Nations in 1971. In order to adjust itself to the new and unfavourable diplomatic reality, the Nationalist Government in Taiwan permits investments made by nationals from 'friendly countries', in addition to these coming from countries which still have diplomatic ties with it. The term 'friendly countries' refers to the non-communist countries with no diplomatic relations with the Nationalist government, whereas 'unfriendly countries' refers to the Communist countries, such as Cuba. Thus, "whether or not there is a diplomatic relationship is no longer of any importance" (Don, 1979: 19).

this is that Taiwan's municipal law apparently permits incorporation by a person who has none of the links with his 'home' state which are required to support diplomatic protection of individuals.³⁵ For example, a company may incorporate in some country, such as the British Virgin Islands, whose law is favourable to its purposes (usually for tax reasons). Apart from paying taxes and filing an annual return, the company may have no further connection with its country of registration. This company then could invest in the ROC as a foreign juridical person and thus enjoy tax preferences. Although the foreign company must have an 'operation of business' in the country of incorporation in order to be recognised by the ROC government,³⁶ it is in practice very difficult for the government authority to know if the foreign company does operate a business in the country in which it is incorporated. In fact, there has been considerable regulatory concern about investment made by corporations incorporated in tax-haven countries since the liberalisation of foreign exchange in 1987. The Government is wary of possible tax evasion and of money laundering or other criminal activities by Taiwan citizens and residents remitting money out of Taiwan, under the Outward Regulations, and setting up such corporations for reinvestment in Taiwan. It is to be hoped that this deficiency will be reminded in the next law reform.

By contrast, the test of 'substantial interest' has been adopted by the ROC for the purposes of investment treaties. Article 1 of the ROC-Nicaragua Investment Guarantee Agreement defines the term 'companies' as "companies or juridical persons which are incorporated in the contracting states, in which nationals of either contracting party own more than 50 per cent of shares of the company". In terms of bilateral treaties, variations amongst treaties concluded by the ROC tend to reflect

³⁵ See *Nottebohm Case*, *I.C.J. Reports* (1955: 4); U.N. ST/LEG/SER.F/1 (1992: 29, 32).

³⁶ Article 371 of the Company Law.

differences in the law of the other contracting State. In order to conform with Nicaraguan notions of the nationality test for juridical persons, the ROC-Nicaragua Agreement adopts the ‘incorporation’ and ‘substantial interest’ test.

Article 1 (c) of the Agreement between the Government of the Republic of China and the Government of the Kingdom of Lesotho for Promotion and Protection of Investments (cited hereinafter as the ROC-Lesotho Investment Protection Agreement)³⁷ provided that:

“companies” means

(I) in respect of Lesotho corporations, firms or associations incorporated or constituted under the law in force in the territory.

(ii) in respect of the Republic of China, corporate juridical persons organised and incorporated in accordance with the Company Law of the Republic of China for the purpose of profit making.

The parties to a treaty may well use identical tests for determining the nationality of a juridical person; yet the underlying rule is that nationality is determined by the municipal law of each state. This rule has also been adopted in the Agreement between the Taipei Economic and Trade Office and the Indonesian Chamber of Commerce to Taipei for the Promotion and Protection of Investments³⁸ (cited hereinafter as the Taipei-Indonesia Investment Protection Agreement).

To compound the difficulties, for questions of diplomatic protection, it should also be mentioned that the ROC has not established any legislative standard whatsoever for distinguishing between juridical persons of a private nature and those of a public nature. This question may in principle be approached in two ways:

³⁷ Signed on December 1, 1982 (TRFS, 1986, vol. 7: 133-139). However, the ROC and the Kingdom of Lesotho terminated diplomatic relations on May 14, 1983; all of the treaties, agreements and exchange of notes between the two countries have been suspended from operation unless otherwise agreed upon by the Parties.

³⁸ Signed on December 19, 1990 and entered into force on the same day (TRFS, 1993, vol. 8: 263-267). (Indonesia does not have diplomatic relationship with the ROC.)

either by recourse to the legislation of the country of origin of the juridical person whose public or private nature it is desired to determine, or by establishing some internal qualificatory criteria (qualification according to the *lex fori*) that may serve as standards for settling the question and be applied in a general way to all foreign juridical persons, whatever their country of origin.

Given that the ROC does not have diplomatic relationships with most countries in the world, the first approach may be the more practical. Enforcement of its own views regarding a foreign juridical person's public or private personality would seem unnecessarily difficult in a country which is not generally recognised as having sovereign status.

10.1.2 Overseas Chinese

Surprisingly, there is no definition of the term 'overseas Chinese' under the SIOC, the most important law to regulate the investments made by overseas Chinese. The only provision defining the term 'overseas Chinese' occurs in the Statute for Technical Co-operation (STC). Under Article 2 of the STC, overseas Chinese "refers to nationals of the Republic of China residing outside of the territory of the Republic". In other words, overseas Chinese are merely those who have ROC nationality but are living overseas. However, in practice, the authorities adopt a much broader definition of the term 'overseas Chinese', to include: (1) nationals living overseas who hold a valid ROC passport; and (2) ethnic Chinese holding a foreign passport (Kuo, 1989: 67). In order to enjoy the privileges available under the SIOC, overseas Chinese have to apply for Overseas Chinese Identification Cards which confer the right to work, buy real estate, and hold full civil rights in Taiwan.

Generally speaking, both foreign and overseas Chinese investors must comply with the same domestic investment legislation (Don, 1979: 17). However,

the ROC investment laws specifically governing foreign investment draw a distinction between overseas Chinese investors and their non-Chinese counterparts.³⁹ An obvious question is whether this is racial discrimination. For this question, we first have to examine how nationality can be acquired under the ROC law. In principal, the acquisition of ROC nationality is governed by the test of descent from a national (*jus sanguinis*)⁴⁰ and, in exceptional cases, by the test of birth within the state territory (*jus soli*).⁴¹ Furthermore, Article 11 of the Nationality Law⁴² contemplates that any person who intends to renounce his ROC nationality may only do so by obtaining permission from the Ministry of the Interior.⁴³ In other words, a Chinese who is born abroad having a Chinese father remains Chinese until he has gone through this administrative formality. Therefore, most overseas Chinese have dual nationality. Under general principles of international law, a dual

³⁹ Article 1 of the SIOC: "Matters relating to the encouragement, protection, and administration of domestic investments by overseas Chinese shall be governed by this Statute." Also *cf.* Article 2 of the STC.

⁴⁰ Article 1(I) (1)-(3) of the ROC Nationality Law stipulates that the following persons are of the nationality of the Republic of China: (1) Any person whose father was, at the time of that person's birth, a Chinese national; (Since the Nationality Law was enacted in 1929, before the Chinese civil war, there is no recognition of the distinction between the ROC and the PRC.) (2) Any person born after the death of that person's father who was, at the time of his death, a Chinese national; (3) Any person whose father is unknown or stateless but whose mother is a Chinese national.

⁴¹ Article 1(I) (4) of the ROC Nationality Law: "The following persons are of the nationality of the Republic of China: ...; (4) Any person born in Chinese territory whose parents are both unknown or stateless."

⁴² The ROC Nationality Law was promulgated and effective as of February 5, 1929.

⁴³ Apart from obtaining permission to this effect from the Ministry of Interior, any person who intends to give up his ROC nationality has to be at the age of twenty years or more and must have disposing capacity under Chinese law. See article 11 of the ROC Nationality Law.

national (of a foreign country and the host state) is considered a national of the host state, unless the host state decides to afford the national different treatment.⁴⁴

By separating the overseas Chinese investors from foreign investors, it is clear that the ROC investment laws do not formally regard the former as foreign investors in the full sense, although in fact there is no very substantial difference between the content of the enactment governing the overseas Chinese investors and that regulating foreign nationals. Why does the law separate overseas Chinese investment from foreign investment? The ROC laws are influenced a great deal by traditional Chinese culture. One's 'roots' are rarely forgotten by the Chinese people. As long as one of a person's ancestors was Chinese, Chinese people would assume that the person has 'Chinese blood', and would think of him differently from foreigners, no matter what nationality he has or how long he has been abroad. Given the tradition of Chinese nationalism, it is not difficult to understand why the ROC government symbolically does not treat foreigners and overseas Chinese on an equal footing when enacting the investment laws. Because overseas Chinese are regarded as Chinese in the ROC, regardless of what nationality they have, it is clear that the discriminatory treatment between overseas Chinese and foreign nationals is based on racial grounds.⁴⁵ A basic rule of international law prohibits racial discrimination. However, Brownlie (1989: 9) has argued that "the fact that the primary criterion involves a reference to race does not make the rule discriminatory

⁴⁴ For example, Poland and Vietnam both have special investment codes dealing with investments made by expatriates (nationals of the host state residing abroad) either alone or jointly with host country residents. See Mahmassani (1988: 286) and Shihata (1993: 69).

⁴⁵ Discrimination based upon racial grounds may, in certain circumstances, violate *erga omnes* obligations (i.e. obligations binding on all states that also have the status of peremptory norms [*jus cogens*]). In the *Barcelona Traction Case* (Second Phase). The Court said "such obligations derive, for example, in contemporary international law, from the outlawing of acts of aggression, and of genocide, as also from the principles and rules concerning the basic rights of the human person, including protection from slavery and racial discrimination" *I.C.J. Report* (1970: 3).

in law, provided the reference to race has an objective basis and a reasonable cause".⁴⁶ Sornarajah (1994: 103) has also claimed that "except in the case it is clearly directed at [i.e. against] an ethnic group,⁴⁷ there cannot be any international wrong committed by discriminating between investors or types of investments". He has also stated that "there cannot be a blanket rule of such a nature. Much will depend on the exact circumstances of each state's situation." (1994: 136) Given that there is little significant difference in practical legal content between the SIFN and SIOC, and given that the symbolical difference between these two laws is derived from traditional Chinese nationalism and culture, it is unlikely that the rule against racial discrimination is violated by the ROC laws.

However, because the ROC government has adopted such a broad definition of 'overseas Chinese', some local opportunists have taken advantage of this definition and there have been many cases of 'false overseas Chinese local investment'. In order to clarify the meaning of 'overseas Chinese', it is submitted that there should be a clear definition of the term 'overseas Chinese' under the SIOC. This would necessitate amending the existing legislation.

Many overseas Chinese investors have their own companies in the countries in which they live, and in many cases, some of companies owned by overseas Chinese are MNEs. Can those investors make investments in Taiwan using an 'overseas Chinese company' as investor? In other words, does the term 'overseas Chinese' under the ROC investment laws include 'overseas juridical Chinese'? The

⁴⁶ This formulation has been criticised by some jurists, who suggest it can be used to "cloak racial discrimination" (Sornarajah, 1994: 104).

⁴⁷ For example, certain measures taken recently by Australia may be directed against Japanese buying real estate in Australia. This could raise a question whether it amounts to discriminatory treatment of foreign nationals on racial grounds. For more on the rules regarding ownership of land by aliens, see the *Sramek Case*, [1984] YBECHR 294 and *Land Sale to Alien Case (I)*, [1973] 77 I.L.R. 433.

STC indicates that an overseas Chinese has to have Chinese nationality. We have seen that under the ROC Company Law if the company is incorporated in countries other than the ROC, it is treated as a foreign juridical person. In addition, there is also the political consideration that the Government must avoid permitting Taiwan's economy to be influenced by mainland China. Unfortunately, it is difficult to identify whether a foreign company has mainland shareholders. For these reasons, if an investment is made under the name of an overseas juridical Chinese, the competent ROC authority will treat it simply as a foreign judicial person (Kuo, 1989: 71). The term 'overseas Chinese' therefore only refers only to overseas natural Chinese person; it does not include overseas juridical Chinese person. It must be said that this conservative attitude is not consistent with the current liberalisation of investment policy and, by contrast, it will only make foreign Chinese-controlled or -owned MNEs reluctant to invest in Taiwan.

10.1.3 Investment

The ROC investment laws have also failed to provide a positive definition of investment. Articles 3 and 4 of the SIFN and SIOC only define kinds and types of investment.

(A) Kinds of Capital Investment

Article 3 of the SIFN is identical to Article 3 of SIOC. In it, the following are listed as assets that may be used in payment constituting foreign investments:

- a) Cash in the form of foreign exchange, which is remitted or brought in;
- b) Machinery and equipment or raw materials imported for own use against self-provided foreign exchange;
- c) Technical know-how or patent rights; and
- d) Investment principal, capital gains, net profits, interest or any other income generated as a result of transfer of investment, reduction of capital or dissolution/liquidation approved by the government.

In accordance with this article, there are three different types of capital contribution: (i) cash investment, (ii) material investment, and (iii) technical know-how or patent rights investment. No matter what kind of capital contribution is made, the investor becomes the shareholder of the company in which he invested. This kind of investment is known as 'equity investment', as opposed to 'loan investment'. Foreign investors can also make their capital investment in the form of a loan (Article 4 (I)(2)); however, as mentioned in Chapter 1, this research deals only with 'direct' investment, and the 'indirect' investment (such as by loan) will not be considered here.

(i) Cash Investment

Cash investment comprises foreign currency funds remitted or carried into Taiwan by foreign investors. It is recognised by the Government as a proper source to fund an FIA investment only if the funds are remitted or carried into Taiwan following the issuance of the FIA approval (Liu, 1994: 141). The cash investment may be reserved and deposited in its original form until such time as it is needed for investment purposes (Huang, 1988: 98). If, as is usual, the funds are remitted by telegraphic transfer, accompanying documentation must state that such funds represent investment approved by the IC with reference to the number of the IC meeting when approval was obtained, and the amount of foreign currency to be retained, if any. If the cash is to be brought in by an individual, the cash must be registered with the customs office at the port of entry (Kuo, 1989: 136).

Where a foreign investor has made an FIA investment in Taiwan he can make another investment using the investment proceeds from the first project provided the new project itself obtains an FIA approval. Thus an FIA foreign investor receiving net profits (such as dividends and shareholders' bonuses), interest (such as interest from a 'loan investment' in Taiwan), or other proceeds in Taiwan may reinvest such earnings within Taiwan to constitute a further foreign

capital investment under Article 3. This further FIA project may involve an investment in the same subsidiary or in an entirely different company. Similarly, as the shareholder's capital increases (via capital gains or returns on capital), such increase can be formally capitalised after related taxes have been deducted and paid.

There are a number of comments that need to be made about cash investment. First, it seems somewhat unreasonable that the investment laws do not allow a foreign investor to finance his investment with local currency. As we discussed in the preceding section, an investment has the quality of 'foreignness' not because of the means of payment employed but from the fact that the investment is effected by certain persons. In particular, since the liberalisation of foreign exchange in 1987, opportunism by way of exploiting the FDI process to obtain foreign exchange is no longer a relevant concern. It is possible for foreign non-FIA investors to use NT\$ to invest in Taiwan in FIA-prohibited or -restricted industries. At present, in such a case, foreign investment status will not apply - surely an odd legal situation.

Secondly, given the current FDI policy of liberalisation, one can see no reason for the Government to restrict the kinds of permissible cash investment made by foreign investors. It is suggested that, in principle, as long as a foreign investor invests in Taiwan using valuable assets - of whatever type - those assets should be regarded as investment.⁴⁸

(ii) Material Investment

A foreign national or overseas Chinese may import machinery and equipment or raw materials for his own use as investment provided the foreign

⁴⁸ Subject, of course, to administrative approval, to be exercised in control of assets which might adversely affect the public good in some way, e.g. national security, the environment, etc.

exchange used in buying such goods comes from a source outside the ROC. These items must have been paid for in foreign exchange provided by the investor. As to whether the machinery and equipment must be new or may be used, the SIFN and SIOC are silent.

Generally speaking, prevailing government policy bars the importation of used machinery and equipment (see Guidelines for Screening of Used Machinery and Equipment to be Imported Under Investment Project Proposed by Overseas Chinese and Foreign Nationals).⁴⁹ The purpose of this regulation is to prevent obsolete equipment from being dumped in Taiwan for the production of inferior quality products. However, special permission to import used equipment or machinery may be granted upon the submission of justifying reasons; it may be considered an acceptable reason if new machinery of the same type is not available or if the machinery is under lease on a cost-free basis.

In order to avoid the importation of outmoded machinery or equipment from developed countries, it is suggested that this concern could be made an explicit constraint upon the discretion to give special permission, e.g. by requiring that such permission may only be granted 'provided the items are in accordance with up-to-date technical development suitable for the ROC as prescribed by the Ministry of Economic Affairs'.⁵⁰

(iii) Technical Know-how or Patent Rights Investment

It is worth noting that the kinds of investment employed in the SIFN and SIOC include not only tangible but also intangible assets, such as technical know-

⁴⁹ Promulgated by the Investment Commission on March 17, 1980.

⁵⁰ Cf. Section 3 (b) of the Encouragement of Investment Act, 1980, of Sudan.

how and patent rights.⁵¹ This is justified by the fact that the purpose behind the invitation of foreign investment to the ROC is not only to solicit the capital itself but also for the sake of expertise and technology which the ROC needs in order to achieve its goal of industrialisation, by exploiting its relatively inexpensive⁵² and well-educated population, and to help its population to acquire the technical knowledge required for better management of the developmental projects already embarked upon.

A foreign investor may contribute know-how or patent rights to its subsidiary in return for an equity interest. However, the SIFN and SIOC do not elaborate, describe, or specify these items and contain no detailed instructions for the Ministry of Economic Affairs. In the early years, the Ministry allowed only a fixed sum of money, in one payment or in instalments, as compensation for technical know-how despite the statutory provision that technical know-how could become equity capital. (Liu, 1973: 256) Dissatisfied with this way of handling the matter, the MOEA promulgated the Regulations Governing the Use of Patent Rights and Technology Know-how As Equity Investment (cited hereinafter as

⁵¹ There is no question that the ROC laws include intangible assets in this definition. By contrast, some other countries impose stringent requirements as to the valuation of intangible assets contributed in exchange for shares. In addition, many governments take a more restrictive approach than the ROC to the types of intangible assets that may qualify as capital assets for special investment incentives, e.g. by not permitting certain intangible assets such as unpatented know-how to be capitalised at all (Friedman, 1959: 746-756).

⁵² As of the end of 1994, the average monthly labour wage in Taiwan was US\$ 1,275. The average monthly labour wage in the manufacturing field was US\$ 1,162, and in the service industry was US\$ 1,362. Although no longer competitive with some less-developed nations, the average wage level in Taiwan remains relatively lower than the other major industrial countries. Compared with Japan, Germany, the US, France and Korea, where the hourly wages in manufacturing industries were US\$ 22.71, 15.17, 12.06, 7.86 and 6.01 respectively, the hourly wage in Taiwan was only US\$ 5.74, slightly higher than that of Hong Kong (US\$ 5.43) (National Statistics Agency, 1995).

‘Technology Investment Regulations’) for its own guidance in technical know-how or patent rights cases.⁵³

The Technology Investment Regulations that supplement Article 3 of the SIFN and SIOC are stringent. Under the Regulations, to qualify for equity capital the technical know-how must be in a newly developed technology, must have an economic value, must be indispensable for the projected enterprise and, importantly, must not have been previously used in Taiwan (Article 3). Recognised as patent rights will be those patents which are approved by the Government of the ROC as a new invention, a new model, or a new design (Article 2),⁵⁴ foreign patent rights are excluded. In other words, the qualifying patent rights are limited to those registered under the ROC Patent Law,⁵⁵ and foreign investors may not simply use their foreign patents as capital contribution as if they were ROC patents. Unless the investor holds an ROC patent, the subject matter would be treated as unpatented know-how for the purposes of capital contribution under the SIFN and SIOC.

Patent rights or technical know-how may be capitalised as equity investment if the technology (whether it takes the form of unpatented know-how or ROC patent rights) has the capability to produce a new product which cannot at present be produced or manufactured in Taiwan; or if the technology can be used for improvement of the quality or production cost of existing products (Article 4).

⁵³ The Regulations Governing the Use of Patent Rights and Technical Know-how as Equity Investment was approved by the Executive Yüan on May 9, 1968 and promulgated by the Ministry of Economic Affairs on June 3, 1968.

⁵⁴ See also Article 1, 95 and 111 of the Patent Law for definitions of ‘new invention’, ‘new model’ and ‘new design’, respectively.

⁵⁵ The Patent Law was promulgated on May 29, 1944, and amended on January 22, 1959, May 12, 1960, April 16, 1979, December 24, 1986, and January 21, 1994.

The maximum proportion of equity investment made by capitalising patent rights or technical know-how is also regulated by Article 6 of the Technology Investment Regulations. Technical know-how may only represent up to fifteen per cent of total paid-in capital; technical know-how in the form of patent rights may account for up to twenty per cent. Other than in the case of patented know-how, a matching cash investment or other form of investment must also be made, equalling or exceeding the value of the technical know-how invested. Therefore, a foreign investor cannot eliminate the need to fund the operation by contributing know-how. By contrast, a foreign investor contributing ROC patents is not subject to this matching requirement.

The shares issued in return for the know-how contribution may not be transferred until two years after the completion of the approved investment. Similarly, shares issued corresponding to patent rights may not be transferred during the effective period of the patent rights. Once contributed, such patent rights and technical know-how may not be transferred or reinvested in any other enterprise in Taiwan.⁵⁶ It is worth noting that, compared with technical know-how, the patent rights contribution is subject to a potentially longer period during which transfer may not be allowed. Taiwan grants patent rights for new inventions, new utility models, and new designs for fifteen, ten, and five years, respectively.⁵⁷ Therefore, the restrictive transfer period for technology shares issued for know-how could be considerable (Liu, 1994: 144). Furthermore, although no tax is imposed on the investment of know-how or patent rights, the full amount of the proceeds from the sale of such shares will be considered a capital gain for tax purposes (Huang, 1988: 99).

⁵⁶ Article 8 of the Technology Investment Regulations.

⁵⁷ Article 6, 99 and 114 of the Patent Law.

Another important feature of investment by way of patent rights and other technology is that evidence substantiating the declared worth of technology must be approved by the Investment Commission.⁵⁸ The valuation process may be lengthy and involve supplementary filings and some ‘bargaining’ with the regulators.⁵⁹ The practical implication of this is to make technology a kind of foreign investment which cannot be carried out freely, even when the percentage limits established for foreign participation are respected. The reason for this very conservative attitude on the part of the legislature is not clear.

In light of the foregoing discussion, one can see why foreign investors are typically unwilling to contribute know-how or patent rights in order to reduce their capital outlay. In addition to this obvious drawback, a further defect of the current laws is that they decrease the opportunity for upgrading Taiwan’s industries by recognising only technical know-how and patent rights for the purposes of entitlement to the privileges and benefits provided by the SIFN and SIOC.⁶⁰ Intellectual property rights include, but should not be limited to, know-how and patent rights. Trade marks and copyrights, for instance, are also important intellectual property rights. In order to show that the ROC respects intellectual property rights, and in order facilitate continued upgrading of Taiwan’s industries, it is suggested that the present laws should be amended and the variety of permissible of investment should be broadened, especially regarding intellectual

⁵⁸ A detailed description of the technology, including its function, capability, production, economic value, the basis of the pricing recognition requested by the foreign investor, contribution and restrictive transfer undertakings, and other related documents, will have to be submitted for close scrutiny. See Article 5 of the Technology Investment Regulations.

⁵⁹ Frequently, the government estimates the value of the intangible assets at a much lower level than its real potential (Hsu, Li, and Wang, 1985: 576).

⁶⁰ Article 131 (III) of the Company Law implies that trademark rights may be capitalised. It states: “the payment for shares as mentioned in the first paragraph may be made in assets required in the business of the company”.

property rights. Additionally, the rather cumbersome constraints on investment of technology seem an unnecessary deterrent to prospective investors.

(B) Forms of Capital Investment

Article 4 of the SIFN and the SIOC contemplate several forms of foreign investment admissible in Taiwan. First, foreign investors may set up essentially wholly-owned subsidiaries in Taiwan. However, as analysed in Chapter 9, the Company Law requires at least seven shareholders for a company limited by shares. Therefore, such foreign investors would need to secure at least six foreign or Taiwanese natural or juridical persons to each own a ‘qualifying share’ in order to duly incorporate a company in Taiwan.

Secondly, foreign investors may set up joint venture enterprises with ROC natural or juridical persons or with the ROC government. Article 27 of the ROC Company Law permits government entities to become shareholders in, for example, a company limited by shares.⁶¹ The affirmative policy of the ROC government is normally to permit foreign investors to set up wholly-owned subsidiaries in Taiwan, although in some industries joint ventures are the only way for foreign investors to make an FIA investment in Taiwan. Where a joint venture is required in order to institute a foreign investment, the foreign investors may be required to invest as minority shareholders. Such joint ventures are required, for example, in the areas of investment in local securities companies that engage in underwriting, brokerage, dealing, or a combination of such operations, and investment in automobile manufacturing. Some of these restrictions are embodied in definitive laws or regulations, while others are based upon administrative policies. In terms of

⁶¹ Article 27 of the Company Law: “In case the government or juridical person is a shareholder....”

international law, such discrimination against foreign nationals is considered lawful as long as “it is based on sound economic grounds” (Sornarajah, 1994: 102).⁶²

Thirdly, foreign investors may make additional investment for the purpose of expanding their original investment enterprise as a recognised FIA investment. Such foreign investment may be, for example, another cash investment to constitute a capital increase (Article 267 of the Company Law). Alternatively, for the same purpose, foreign investors may capitalise their retained earnings in FIA subsidiaries in Taiwan, thereby receiving stock dividends.⁶³

Fourthly, in addition to making an investment in Taiwan from scratch, the SIFN and SIOC contemplate that foreign investors may invest in an existing Taiwanese enterprise by acquiring shares from some or all of its shareholders, or by obtaining additional newly-issued shares from such a company. In fact, this take-over form of foreign investment has become more popular in recent years. Sometimes this technique is used to structure a joint venture, while other take-overs

⁶² In the *Oscar Chinn Case* (1934), the Permanent Court stated that equal treatment was required only between entities in a like group (*P.C.I.J. Series A/B*, no. 64). See also Article 50 of the Proposed Text of the Draft Code on Transnational Corporations: “States have the rights to regulate the entry and establishment of transnational corporations including determining the role that such corporations may play in economic and social development and prohibiting or limiting the extent of their presence in specific sectors.” (UNCTC, 1988: E/1988/39/Add 1). Guideline II, Section 4 of the of the World Bank’s Guidelines on the Treatment of Foreign Direct Investment also provide that “without prejudice to the general approach of free admission recommended in Section 3 above, a State may, as an exception, refuse admission to a proposed investment: (i) which is, in the considered opinion of the State, inconsistent with clearly defined requirements of national security; or (ii) which belongs to sectors reserved by the law of the State to its nationals on account of the State’s economic development objectives or the strict exigencies of its national interest.” (31 *I.L.M.* [1992] 1380).

⁶³ In the past, the ROC imposed requirements for such expansion projects to be approved. For example, in the case of a manufacturing operation, a plan improvement or expansion project was often required (Article 13 of the SEI). This is no longer the case.

are investments designed to enable a company to become more international and, eventually, to become a public listed company in Taiwan.⁶⁴

Fifthly, ROC law also recognises foreign investment in the form of corporate bonds issued by Taiwan companies as a form of FIA. Such investment is becoming more popular as Taiwanese companies restructure their combination of shareholders' equity, long-term loans, working capital loans, and even shareholders' loans, to finance their operations. In 1989, an ROC company listed on the Taiwan Stock Exchange floated a US\$ 100 million bond in the Eurobond market which could be converted into shares of the issuer 'when and if' this was permitted by the ROC government (Liu, 1994: 142).⁶⁵ One of the approvals required would be an FIA. This development involves a new level of sophistication in FIA practice, which had in the past been based upon the tacit premise that approval has to be both investor- and project-specific.

Finally, Article 4(I)(3) also specifies that technical know-how or patent rights can be used as capital stock and is a valid type of capital investment. In this, however, it overlaps with the forms of investment which are specified in Article 3. It is suggested that Article 4 should be revised to omit this duplication.

The question of whether an investor's setting up a branch in Taiwan represents a type of investment is not resolved in Article 4 of the SIFN. Rather, Article 6 of the SIFN states that in the case of:

"a foreign company which intends to set up a branch office in the ROC for undertaking productive or manufacturing operations, the protection and disposition of its investment shall be governed by the provisions of this Statute *mutatis mutandis*."

⁶⁴ This is often called 'mezzanine financing' because of the possibility of the invested company going public in the near future.

⁶⁵ This bond is in bearer form and cannot be subscribed by Taiwan residents.

It does not seem to be necessary to have a separate article distinguishing the branch office as a type of investment from other types of investment. And it is ironic that, while spending so much effort in distinguishing various types of investment, perhaps the biggest weakness of the SIFN and SIOC is that there is no clear definition of the crucial term ‘investment’. Although the kinds and types of foreign investment are stated in laws, there is thus no law to regulate the foreign investors’ investment *activities* within the ROC; e.g. there is no specification of the extent and duration of the investor’s participation in its investment required for qualification as FDI - regarded as essential elements of the standard definitions adopted by international scholars and institutions (above, Chapter 10.1). An element of unwelcome uncertainty has thus been allowed to creep into legal measures in which, since their purpose is to attract foreign capital, the most outstanding features should be the sureness and certainty of their rules. It is therefore strongly submitted that a working definition for investment is necessary for the ROC investment laws.

By comparison, in terms of bilateral treaties, Article 1 of the ROC-Panama Investment Protection Agreement gives an elaborate definition of the term ‘investment’:

The term “investment” means any kind of asset invested by investors of one country, in conformity with the laws and regulations of the latter, including but not exclusively:

- (i) movable and immovable property as well as other rights such as mortgages, liens or pledges;
- (ii) shares, stock and debentures of companies or interests in the property of such companies;
- (iii) claims to money or to any performance related to investment having a financial value;
- (iv) intellectual property rights and goodwill;
- (v) licenses and permits issued pursuant to law, including those issued for manufacture and sale of products; and
- (vi) business concessions conferred by laws or under contract related to investment including concessions to search for, cultivate, extract or exploit natural resources.

This is a very wide definition of ‘investment’. Not only does it include all types of property, whether real or personal, but it also includes any interest or rights therein,

tangible or intangible, in addition to rights in technology, patents and copyrights. Paragraphs (v) and (vi) also recognise the fact that many of the rights which an investor obtains in foreign countries are administrative law rights, based upon permission to conduct specified activity in the foreign country. The investment will be significantly affected if rights initially granted are later withdrawn by the administrative agency which grants them. The protection of such acquired rights and privileges is seen as a task of the bilateral investment treaty, which seeks to achieve this by extending the definition of investment to include these public rights acquired under the foreign country's law in the definition of investment. A very similar definition was used in the ROC-Lesotho Investment Protection Agreement. However, the Agreement between the Industrial Development and Investment Centre in Taipei and the Economic Development Board in Singapore on the Promotion and Protection of Investments⁶⁶ (cited hereinafter as Taipei-Singapore Investment Protection Agreement), 1990, seems to have adopted a narrower definition:

“investment” means every kind of asset legally permitted by the relevant places including, but not limited to, any:

- (a) movable and immovable property;
- (b) title to money or to any contract having an economic value; and
- (c) intellectual property rights.

This appears to reflect a greater concern in Singapore to protect that Government's administrative autonomy. Nevertheless, given the purpose of protecting nationals' interests in foreign countries, it is understandable that contracting states tend normally to adopt a wider definition of 'investment' in bilateral investment treaties than they do in domestic investment laws.

⁶⁶ Signed on April 9, 1990 and entered into force on the same date (TRFS, 1993, vol. 8: 531-534). (There are no diplomatic relation between the ROC and Singapore.)

However, it is noticeable that there is a discrepancy between the definition of kinds of ‘investment’ found in the ROC investment laws and the definitions found in ROC bilateral treaties so far concluded with some other countries. The investment treaties categorise ‘investment’ into broad types of property, interest and securities. However, ROC investment law merely describes some specific kinds of ‘investment’ which falls short of giving a comprehensive definition of ‘investment’; this way of formulating the concept would seem to be narrower than the treaty provisions decided above. The ROC law reflects the Government’s conservative attitude towards inflows of FDI, whereas bilateral investment treaties mirror the fact that the contracting states are eager to protect their nationals’ property in the other contracting state through the principle of reciprocity. The outcome of all this may be that certain terms agreed upon in the treaty will depart from the municipal law of either party. How then can the problem be solved? In part, this depends on the place or status of treaties in ROC municipal laws. Are they to prevail over statutes or be inferior to them? What happens if it is discovered that a treaty actually contradicts an earlier statute? These and several other questions will be considered in Chapter 11.

10.2 Residence Matters Related to Foreign Direct Investment

A foreign investor (including an overseas Chinese holding a foreign passport) planning to investigate the investment environment or to do business in the ROC, needs to obtain an visitor’s visa in order to carry out feasibility studies on the potential of investment in the sectors he has chosen. If he then decides to make his investment, he may need to secure resident status in the ROC for himself or for others/his employee(s) so as to oversee such investment projects.

In order to upgrade Taiwan's management skills, the Government prefers foreign investors to localise their management team. Nevertheless, investors often need to delegate managers, technicians, and other employees from their own organisations - especially if the investment involves technical assistance, patents or manufacturing licences. It may be advisable, or even necessary, to bring in personnel specialising in the techniques or processes the investor seeks to introduce, who will reside in the ROC in order to ensure a successful venture. In such cases, the foreign investors must also obtain work permits from the competent authorities for their foreign employees and workers.

The procedure for obtaining visas and work permits is well regulated by the law,⁶⁷ and does not require special consideration here. However, because immigration considerations are in practice so essential to the successful implementation of an FDI proposal, it is appropriate here to analyse the legislation regarding residence and foreign workers in so far as it relates to FDI in the ROC.

The validity of immigration provisions under international law is well established. It is generally recognised that a State is under no duty, in the absence of treaty provisions, to admit or not to admit aliens into its territory (Brownlie, 1996: 519; Brierly, 1963: 276).⁶⁸ The reception of aliens is "a matter of discretion" (Oppenheim, 1996: 897). Even if a state does allow entry to an alien, it may impose such conditions on admission as it may deem fit, usually consistent with its national security, foreign policy and economic policy (Sornarajah, 1994: 100-101). This

⁶⁷ For the procedure for obtaining visas, see the Regulations Governing Issuance of Visas on Foreign Passports (cited hereinafter as 'Visa Regulations'). Promulgated on September 27, 1985. The last amendment of the Visa Regulation was on June 15, 1995 by the Executive Yuan under its administrative decree series Tai (84) Wai Tzu No. 21273. For the procedure for obtaining work permits, see Employment Services Law.

⁶⁸ Oppenheim (1996: 897) has also stated that "By customary international law no state can claim the right for its nationals to enter into, and reside on, the territory of a foreign state".

fundamental principle of international law has been accepted by many publicists,⁶⁹ as well as in treaties,⁷⁰ international conferences,⁷¹ and in State practice.⁷²

However, protection of aliens may be secured by agreement with investor states.⁷³ Thus States may, by investment treaty, confer on each other's nationals a right to enter their territories. The ROC-Paraguay Guarantee Investment Treaty emphasised the necessity of simplifying the immigration laws in order to encourage and promote investment by nationals of either party:

Nationals of one contracting party whose investments are in the territory of the other contracting party shall be granted a residence visa. This shall apply to the investment projects' directors, administrators, and technicians as well as their families (Article 2 (2)).

Either contracting party shall issue multi-entry visitor visas to nationals of the other contracting party if the nationals are the investors, directors or technicians of the investment project and if such investment project has special economic benefits to the contracting party (Article 4).

⁶⁹ Such as Oppenheim (1996: 897-900); Sornarajah (1994: 83, 103); Brownlie (1996: 519-521); Schachter (1990: 314); Plender (1984); Goodwin-Gill (1978: 23).

⁷⁰ For instance, the investment treaty between the United States and Italy which provides for the admissions of aliens by reference to "public order, morals, health or safety". See also, the European Convention on Establishment, 1955 (529 U.N.T.S. 141); the Havana Convention of 1928, 23 *A.J.I.L.* [1929] Spec. Suppl., p. 234; European Convention on Human Rights (23 *I.L.R.* [1956] 393). In addition to the above treaties, various soft-law instruments incorporate this principle. For example, General Assembly Resolution on the Establishment of a New International Economic Order, Res. 3201 (S VI) (1974), 13 *I.L.M.* [1974] 715; 68 *A.J.I.L.*, [1974] 251; Para. 7 of the OECD Guidelines for Multinational Enterprises (1976): "Every State has the right to prescribe the conditions under which multinational enterprises operate within its national jurisdiction, subject to international law and to the international agreements to which it has subscribed. The entities of a multinational enterprise located in various countries are subject to the laws of these countries." (15 *I.L.M.* [1976] 967; OECD (1994)).

⁷¹ E.g., the International Conference on 'Treatment of Foreigners', held in Paris in 1929, League of Nations Doc. C.I.T.E. 62, 1930: 419-421

⁷² For example, *MARK and Another v. Minister for Foreign Affairs*, the Netherlands, Judicial Division of the Council of State (99 *I.L.R.* [1989] 39). The Court observed that "the Dutch authorities had issued regulations limiting the admission of aliens into the country in order to avoid the attendant social problems that would otherwise result from such a policy. This policy was deemed to be in the [interest of] public order".

⁷³ For literature on this concept, see Borchard (1915); Dunn (1932); Brownlie (1983); Lillich (1984).

However, if the immigration status of an investor is not covered by a bilateral investment treaty of this sort, the general rules of international law will apply, leaving it within the sovereign right of a State to decide whether or not to admit aliens into its territory.

10.2.1 Entry Visas and Residence

(A) General Visa Regulations

Reciprocity is the general principle applied by the ROC Ministry of Foreign Affairs (MOFA) in issuing visas to holders of foreign passports (Article 2 of the Visa Regulations).⁷⁴ There are four kinds of visas that may be granted to eligible foreign passport holders: diplomatic visas, courtesy visas (protocol visas), resident visas, and visitor visas (Article 4 (I) of the Visa Regulations). According to the Visa Regulations, there are two types of visas available to visitors for investment purposes: visitor visas and resident visas.

The Visitor visa is applicable to foreign nationals or overseas Chinese who hold an ordinary passport or other travelling documents for transit, tour, visit, study, business, or other reasons and plan to stay in the ROC for less than six months (Article 12 of the Visa Regulations). The Resident visa is applicable to foreign nationals or overseas Chinese who hold an ordinary passport or other travelling documents and come to Taiwan to join relatives, for schooling, investment, employment, missionary services, or other business, and plan to stay for more than six months (Article 9 of the Visa Regulations).

⁷⁴ As of June 1995, the Ministry of Foreign Affairs is allowed to issue non-visa and landing visa entry permit to fifteen countries' citizens, including the US, Canada, Japan, the UK, France, Germany, Netherlands, Belgium, Luxembourg, Austria, Sweden, Spain, and Portugal (IDIC, 1996c: 53).

Holders of visitor visas are not allowed to work in the ROC, and their passport stamp will expressly prohibit their employment in the ROC. However, it is unclear whether spouses of foreign diplomats may seek employment in the ROC, as no such stamp is placed on their passports. Aside from that minor question, however, the enactment of the Employment Services Law in 1992⁷⁵ reflects a clear trend toward exercising more control over the employment of foreign nationals.

(B) Multi-entry Visa

In an attempt to simplify the review of foreign investors applying for multi-entry visas, the Executive Yüan (the Cabinet) amended the Key Points for Screening Applications for Issuance of Multi-Entry Resident and Visitor Visas to Foreign Nationals (cited hereinafter as ‘Multi-entry Visa Regulations’) on June 16, 1988.⁷⁶ Foreign investors who have invested in Taiwan under an FIA and who need to visit Taiwan frequently for the purpose of promoting or monitoring their business can apply for multi-entry resident or visitor visas (Article 1 of the Multi-entry Visa Regulations). Many of the categories of eligibility are specifically drawn up with foreign investment in mind, and applications do not go through normal immigration channels. This thesis considers these categories below.

(i) Multi-entry Visitor Visa

This is appropriate for foreign nationals and overseas Chinese who intend to make an FIA investment or engage in technical co-operation in the industries encouraged by the ROC government and who, due to business reasons, may need to visit the ROC frequently. The foreign investor, of the designated representative of

⁷⁵ See Chapter 9.2.2 above and Chapter 10.2.2 below.

⁷⁶ The Multi-entry Visa Regulations were promulgated on April 12, 1984 by the Executive Yüan under its administrative decree No. Tai (73) Wai 5496, and amended on June 16, 1988 under its administrative decree No. Tai (77) Wai 15831.

an investing juridical person, may submit an application for the issuance of multi-entry visitor visas for an effective period of one year (Article 3 (I) (2) and Article 4 of the Multi-entry Visa Regulations). If the approved invested enterprise has a paid-in capital of US\$ 100,000, the application must be submitted to the Investment Commission of the MOEA, and an additional visa may be issued for one more person with every US\$ 500,000 increase of the paid-in capital. Such additional issuance is limited to four persons only (Article 3 (I) (1) of the Multi-entry Visa Regulations). It is interesting to note that the ROC laws have a lower threshold for overseas Chinese investors. According to the Key Points for Screening Applications for Issuance of Multi-entry Visas to overseas Chinese Investors,⁷⁷ as long as the paid-in capital of a FIA project reaches US\$ 50,000, the investor can apply for one multi-entry visa.⁷⁸ In addition, with every US\$ 250,000 increase of the paid-in capital, an additional visa can be applied for, up to a maximum of 5 persons.

For a foreign bank which does not have a branch in Taiwan but has frequent business contacts with enterprises or banks in Taiwan, officers of its head office may apply for multi-entry visitor visas, provided the foreign bank assets rank among the top 500 banks in the free world (Article 3 (I) (3) of the Multi-entry Visa Regulations). Other employees of foreign financial institutions having connections with banks in Taiwan may also apply for such visas (Article 3 (I) (4) of the Multi-entry Visa Regulations). In addition, a foreign company whose total trade value with Taiwan reached US\$ 600,000 in the year before the visa application can apply for this type of visa for one of its representatives. For every increment of US\$ 600,000, another visa may be issued, up to a maximum of four such addition visas

⁷⁷ Promulgated on September 23, 1987.

⁷⁸ Overseas Chinese should apply to National Police Administration of Ministry of Interiors for issuance of such visa (Article 1).

for employees of the foreign company (Article 3 (I) (5) of the Multi-entry Visa Regulations). Finally, any person who can demonstrate a positive contribution to the development or expansion of industrial or commercial business in Taiwan may apply for the issuance of a multi-entry visitor visa (Article 3 (I) (6) of the Multi-entry Visa Regulations).

(ii) Resident Visas

Foreign investors can apply for resident visas from MOFA after the invested enterprises are approved. Foreigners who are the ‘lawsuit proxy’ or ‘other business proxies’ of foreign enterprises, and who often need to stay in Taiwan, may apply for resident visas. They must apply to the Investment Commission for certificates of relevant status and submit relevant documents to the MOFA for issuance of resident visas.

The Regulations Governing Entry, Exit, Residence and Stay of Foreign Nationals⁷⁹ stipulate that foreigners should report to the local police station to apply for a Foreigners’ Residence Certificate within 15 days after entering Taiwan (Article 8).⁸⁰ A foreigner holding a single entry resident visa, who finds himself needing to exit and re-enter the country, may apply to the National Police Administration of the Ministry of the Interior for issuance of a re-entry visa.

In order to obtain a multi-entry resident visa for one year, a foreign investor having made an FIA investment of US\$ 100,000 or more may, based upon a stated business need, apply or have representatives of the corporate foreign investor apply

⁷⁹ Promulgated as per Ministry of Interior directive, No. 78-Tai-Nei-Jing-661280, dated January 6, 1989. The last amendment was on September 7, 1996.

⁸⁰ Before the law was revised in 1996, Article 5 provided that “Prior to departure, foreigners should make a report to local police station for registration if they are leaving the country for the first time”. The 1996 revision deleted this article, evidencing the Government’s commitment to reduce bureaucratic procedure.

to the Investment Commission for the issuance of multi-entry resident visas by the MOFA (Article 2 of the Multi-entry Visa Regulations).

There are quotas for such visa holders: a foreign investor having made an investment of US\$ 100,000 or more in Taiwan may obtain a resident visa for one person, and for each increment of US\$ 500,000 of foreign investment another person may obtain a resident visa, so long as there are no more than four such additional issuance (Article 2 (I) (1) of the Multi-entry Visa Regulations). Where a branch of a foreign company has been recognised and set up in Taiwan, the representative of the Taiwan branch may obtain a multi-entry resident visa if its operational capital exceeds US\$ 100,000. Where the amount of operational capital reaches US\$ 500,000, a manager other than the representative of the Taiwan branch may receive a multi-entry resident visa (Article 2 (I) (2) of the Multi-entry Visa Regulations).

The resident visa application by a foreign investor, his representative, or the officer of the Taiwan operation, may include an application for his or her spouse and minor children (Article 2 (I) (5) of the Multi-entry Visa Regulations).⁸¹ However, issuance of a visa to foreign nationals is discretionary by the MOFA. For example, since issuance of multi-entry resident visas is based upon a certain amount of investment in Taiwan, where such amount is reduced, or if the invested enterprise discontinues its operation in Taiwan, the Investment Commission may request the MOFA to cancel the resident visas. The MOFA also has discretion, at the request of the competent authorities, to cancel a visa for any of the following reasons:⁸²

⁸¹ In Taiwan, majority begins with the completion of the twentieth year of age. See Article 12 of the Civil Code.

⁸² Article 14 and 15 of the Visa Regulations.

- (1) if the visa holder has a criminal record in Taiwan or abroad, or has ever been denied entry or expelled by the ROC authorities;
- (2) if the visa holder suffers from a contagious disease, mental illness or other diseases, which may be detrimental to public health or social order;
- (3) if the visa holder has made false statements or withheld important facts relating to the purpose of entry as declared on the visa application;⁸³
- (4) if the visa holder has engaged in employment without the written consent of the competent authorities or any other activities inconsistent with the purpose for applying for a visa; or
- (5) if the visa holder has committed acts of fraud, narcotics drug trafficking, subversion or violence in Taiwan or abroad, or has engaged in speech, deeds or activities detrimental to the national interests or social order of the ROC.

10.2.2 Work Permit

In order to intensify its control of employment of foreign expatriates in Taiwan, the Government enacted the Employment Services Law in 1992. The Law provides for non-discrimination in employment, government support in employment placement, employment enhancement, brokerage of employment of local and foreign workers, and the regulation of foreign workers. Specifically, the employment of foreign workers should not adversely affect job opportunities of Taiwan residents or economic development and social stability in Taiwan (Article 41). Without an employer's sponsorship and government approval, foreigners are not allowed to engage in any work in Taiwan (Article 42).

This rule does not apply to the senior executive. In order to encourage foreigners to invest or to do business in Taiwan, foreigners who have a FIA investment and who hold the position of president of the investment enterprise do not need to apply for work permits. The same exemption applies to the lawsuit proxy and other business proxies of the branches or representative agencies of foreign companies.

⁸³ See *Amco Asia Corp'n v. Republic of Indonesia* (27 I.L.M., 1988: 1281; 17 Y.C.A. [1992] 73). In this case, failure to comply with capitalisation commitments given by the foreign investor were held to justify the cancellation of the permit.

An FIA enterprise requiring technical, management, or operations personnel who cannot be found amongst available qualified persons in Taiwan may apply to employ foreigners or overseas Chinese pursuant to the Rules Governing the Approval of Employment of Foreign Nationals Performing Specialised or Technical Work by Public or Private Enterprises, and Employment of Officers in Enterprises Invested or Incorporated by Overseas Chinese or Foreign Nationals⁸⁴ (cited hereinafter as 'FIA Employment Rules'). In order to be employed, such persons need to meet specific criteria, e.g. that they can install or provide instruction with respect to new machinery and equipment, or they can provide the technical expertise needed to improve the quality of production (Article 6). They, of course, need to provide proof that they are qualified to perform the work.⁸⁵ The hiring quota and term of employment visa are decided by the competent authority on a case by case basis (Article 13). However, persons employed by foreign enterprises as managers will not be restricted by such requirements as work experience, hiring quotas, and termination dates.

Usually, if FIA employment is for any period up to three years, the Investment Commission will grant approval as agreed between the parties. Where the employment arrangement contemplates three years or more, then special approval by the Investment Commission will be required. The employment may subsequently be extended annually (up to five years in total) under a sponsorship by the employer who has demonstrated to the satisfaction of the Government that there

⁸⁴ Promulgated on January 20, 1993.

⁸⁵ The criteria in the Article 4 of the FIA Employment Regulations include: (a) they have graduated from a college and have engaged in such technical or operational work for two years or more; (b) they have graduated from an advanced vocational school and have engaged in such technical or operational work for three years or more; or (c) they have engaged in such work for six years or more.

is a need to continue such employment (Article 49 of the Employment Services Law).

Comparing the situations of foreign and ROC nationals, the legislation described here is guided by egalitarian principles as regards salary and other working conditions which, in the case of foreigners, cannot be inferior to those legally established for ROC nationals. However, the immigration rules establish discriminatory principles which constrain the contracting preferences of foreign investors. For work that does not require very specific skills, a work permit can only be granted, in effect, if there is an employment shortage, and no suitable ROC nationals can satisfy the employer's needs. This preference in favour of ROC nationals does not present a difficulty, of course, in the case of professions or activities where, in the opinion of the Government, there is a recognised shortage of manpower (Article 43).

Chapter 11

Legal Treatment of Foreign Direct Investment in the ROC: Encouragement and Protection

After examining, in the previous chapter, some preliminary questions about the admission of FDI under the current ROC laws, and under the bilateral treaties concluded by the ROC, this chapter deals with certain additional problems concerning the legal treatment of foreign investment, once made, in Taiwan.

The right of a State to control its economic affairs is based upon the principles of economic self-determination and permanent sovereignty over natural resources.¹ The notion of permanent sovereignty has been extended to cover all economic activities of a State² and this notion has been claimed and exercised consistently by European countries.³ However, State sovereignty is subject to any duties derived from customary or treaty-based law, as a result of the authority of the State to limit its own powers (Shaw, 1986: 16).⁴

¹ Article 5 of the Seoul Declaration of the International Law Association (1988) provides that: “permanent sovereignty over natural resources, economic activities and wealth is a principle of international law”. See also UN General Assembly Resolution of 1962 on Permanent Sovereignty over Natural Resources.

² International Law Association, *Report of the Sixty Fourth Congress* (1990: 59).

³ Many European countries have stringent reporting requirements for foreign investment. For example, Austria and Denmark have requirements for registration (UNCTC, 1986, vol. 5: 153; 1988, vol. 6: 152).

⁴ Sornarajah (1994: 119) has claimed that the priority of international law over national law may be explained “either on the ground that international law is a system of higher law or on the positivist basis that there has been consent of the state to be bound by treaty and customary principles of international law”.

In the area of foreign investments,⁵ it is undeniable that treaties on foreign investment can “limit the state’s sovereignty to treat the foreign investor” (Sornarajah, 1994: 119-120) and can “offer firm guarantees to foreign investors, in place of uncertain and contested customary norms concerning the treatment of foreign investment” (Pogany, 1989: 40).⁶ This is because international agreements are bound by the principle of *pacta sunt servanda* (agreements must be observed) and “cannot be repudiated except on certain well-defined grounds” (Pogany, 1989: 42).⁷

The main purpose of this chapter is to discuss the domestic legal treatment of foreign investment in Taiwan. Therefore, customary international law and certain bilateral treaties dealing with the encouragement and protection of foreign investment are important, as well as relevant norms of Taiwan’s domestic law. It should be stressed that certain rules of international law are binding on the ROC.

The treatment of aliens is a very controversial issue under international law. The controversy, in general, stems from differences of approach between countries having different economic and political interests (Shaw, 1991: 503). It is not possible for this chapter to deal with every aspect of this difficult question. Thus, only some of the relevant issues will be examined before the laws of the ROC is discussed. In addition, certain bilateral investment treaties which Taiwan has concluded will be analysed.

⁵ See also Lissitzyn (1963: 58); UNCTC Outstanding Issues in the Draft Code of Conduct on Transnational Corporation E/C.10/1985/S/2 (1985: 53); Trimble (1990: 835).

⁶ See also Pogany (1988: 155).

⁷ These grounds are incorporated in Articles 60-62 of the Vienna Convention on the Law of Treaties, U.N. Doc. A/CONF. 39/27 (1969).

11.1 The Standard of Treatment of Foreign Direct Investment under International Law and in the Law and Practice of the ROC

Before dealing with the kinds of protection furnished to foreign investment by the laws of the ROC and under various bilateral treaties concluded by the ROC, it is important to establish as a reference the standard of treatment required by general international law.

11.1.1 National and International Standards of Treatment

In principle, there are two underlying approaches to the protection of foreign investment - the 'international minimum standard' and the 'national treatment standard'. The former is preferred by developed countries, as it provides a minimum standard of treatment for aliens which a State cannot violate without incurring international liability, irrespective of how the State treats its own nationals,. The latter is favoured by many developing countries, especially Latin American states: it provides for equality of treatment between aliens, including foreign investors, and the nationals of the host country (Shaw, 1991: 512; Harris, 1991: 493-494; Oppenheim, 1996: 931).

Supporters of an international standard argue that international law demands that the treatment of aliens should not fall below an objective standard (Kronfol, 1972: 16). This entails restricting every State's liberty of action by the right of other States to be assured that a certain minimum standard of treatment of their nationals will not be overstepped. This proposition was accepted in the *Neer Case* (1926), where the General Claims Commission, set up by the United States and Mexico, stated that:

“ ... the propriety of governmental acts should be put to the test of international standards ... the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental

action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency" (1926 *R.I.A.A.*, iv. 60; 3 *I.L.R.* 213).⁸

This principle has received extensive support by many tribunals,⁹ by a majority of States at the Hague Codification Conference, 1930, and was affirmed in the Declaration of the United Nations General Assembly in 1962 on Permanent Sovereignty over Natural Resources.¹⁰

By contrast, advocates of the 'national treatment standard' argue that a foreigner is subject to the laws of the country in which he stays¹¹ and that it would contradict the principles of territorial jurisdiction and equality if a foreigner were given privileges denied to nationals of that country (Brownlie, 1996: 523). Supporters of this view do not necessarily contend that domestic law is superior to international law (*ibid.*, 1990: 525). Rather, they oppose the international minimum standard rule because it is a moral standard advocated by developed countries, and because it has often been used as an excuse for foreign intervention (Roth, 1949: 48; Shaw, 1991: 512). The national treatment principle was formulated as early as 1868, in the Calvo doctrine which sought to preclude an international standard of treatment in regard to foreign investments in Latin America (Sornarajah, 1993: 123-

⁸ Shaw (1991: 513) has claimed that in this statement "a fairly high threshold is specified before the minimum standard applies". The concept of an international standard has also been linked with the denial of justice. See *Janes Claim* (1926) 4 *R.I.A.A.* [1926] 82; 3 *I.L.R.* 218; and *Amco v. Indonesia* (27 *I.L.M.*, 1988: 1281; 17 *Y.C.A.* [1992] 73).

⁹ See the *Certain German Interests in Polish Upper Silesia Case* (1926), *P.C.I.J.*, Series A, no. 7; 3 *I.L.R.*, 429; *Garcia and Garza Claim* (1926), 4 *R.I.A.A.* [1926] 119; *Chattin Case*, 4 *R.I.A.A.* [1927] 282; 4 *I.L.R.*, 248; *Roberts Claim* (1926), 4 *R.I.A.A.* [1926] 41; 3 *I.L.R.*, 227; 3 *Annual Digest* [1925-1926] no. 166; the *Hopkins Claim* (1926) 4 *R.I.A.A.* [1926] 411; 21 *A.J.I.L.* [1927] 161; *Annual Digest* [1935-1936] no. 167; and *British Claims in the Spanish Zone of Morocco* (1925), 2 *R.I.A.A.* [1925] 617.

¹⁰ Resolution 1803 (XVII) General Assembly Resolution of 1962 on Permanent Sovereignty over Natural Resources, 13 *I.C.L.Q.* [1964] 398-449.

¹¹ See *Rosa Gelbrunk v. Salvador*, Foreign Relations of 1902: 877. Sir Henry Strong observed in this award that once the alien voluntarily takes the risk of investing in a host country, he "becomes liable to the political vicissitudes of the country in which he thus has a commercial domicile in the same manner as the subjects or the citizens of that state are liable to the same".

124).¹² Apart from a considerable body of support from publicists,¹³ the principle of national treatment has also been approved in some arbitral awards,¹⁴ by some (17) states at the Hague Codification Conference in 1930,¹⁵ and has been incorporated in Article 2(2)(c) of the Charter of Economic Rights and Duties of States, 1974.¹⁶

Ironically, some opponents of the national treatment approach, such as the United States, have at times changed their view when they themselves became a recipient of massive capital investment from other countries.¹⁷ Thus it remains less

¹² Calvo, an Argentinean jurist, claimed that aliens had only those rights and privileges as were accorded nationals and could therefore seek enforcement of such rights only before a national court. The doctrine had been adopted at a number of Conferences of American States (Washington Conference, 1889; Montevideo Conference, 1933). For literature on the Calvo doctrine, see Shea (1955); Lipstein (1945: 130); Freeman (1946: 131); Graham (1971: 289); Adede (1986: 1003-4). Originally, there was no thought that Calvo doctrine should be extended to foreign investment protection. The proposal was made in the context of the taking of real property and physical assets of the foreigner. The idea of foreign investment protection through the principles of state responsibility is a rather later development (Sornarajah, 1994: 124-125).

¹³ These include Sornarajah (1994: 129), and Brownlie (1996: 525-528).

¹⁴ See *Canevaro Case* (1912), PCA, Hague Court Reports, i. 285; 6 *A.J.I.L.* [1912] 746; *R.I.A.A.*, xi. 397; *Cadenhead Case* (1914), 8 *A.J.I.L.* [1914] 663; and the *Standard Oil Company Tankers Case* (1926), 8 *B.Y.B.I.L.* [1927] 156; 22 *A.J.I.L.* [1928] 404; *R.I.A.A.* ii. 781, p. 794; *Annual Digest*, [1925-1926], no. 169.

¹⁵ See Report of Guerrero of 1926, 20 *A.J.I.L.* [1926] Spec. Suppl. p. 176.

¹⁶ U.N.G.A. Resolution 3281 (XXIX), 14 *I.L.M.* [1975] 251. The Charter was adopted in the General Assembly by 120 votes to six, with ten abstentions, and is very controversial: it favours the view of developing countries and contrasts with Resolution 1803 (The General Assembly Resolution of 1962 on Permanent Sovereignty over Natural Resources). The Charter's value as a statement of custom is questionable. The arbitrator in the *Texaco v. Libya Case* (1977) stated that: "Article 2 of this Charter must be analysed as a political rather than as a legal declaration" (*I.L.R.* [1977] 389; 17 *I.L.M.* [1978] 1). Yet, in the *Liamco Case*, the arbitrator considered that Resolution 1803 and the 1974 Charter "if not a unanimous source of law", were both "evidence of the recent dominant trend of international opinion concerning the sovereign right of states over their natural resources" (20 *I.L.M.* [1981] 53). For literature on the Charter, see Maynard (1976: 1-22); Rozental (1976: 309); Hossain and Chowdhury (1984); Hossain (1981); Dolzer (1981: 562-572); Bulajic (1986); Makarczyk (1988); Oppermann and Petersmann (1987).

¹⁷ See, e.g., the arguments of the United States in the *Norwegian Shipowners' Claims* (1922), *R.I.A.A.*, i, 307. See also Article 5 of the Havana Convention of 1928, 23 *A.J.I.L.* [1929] Spec. Suppl., p. 234; Article 9 of the Montevideo Convention on Rights and Duties of States of 1933, 28 *A.J.I.L.* [1934] Suppl., p. 75.

than firmly settled whether modern international law actually establishes an obligation on the host State to grant aliens more than equal treatment with its nationals when the national standard falls below the international standard (whatever that may be). However, it seems reasonable to conclude that more than ordinary national treatment is required.¹⁸ For example, Section III (2) of the World Bank Guidelines states “Each State will extend to investments established in its territory by nationals of any other State fair and equitable treatment according to the standards recommended in these Guidelines”. While this is not necessarily evidence of customary law, the Guidelines may be regarded as indicative of an emerging consensus (Shaw, 1991: 512-513). Nevertheless, it seems doubtful that there is only one single standard: on the one hand, the minimum standard would be higher in a developed country than in a sparsely inhabited and only partially-developed country (Beckett, 1931: 175). On the other hand, in each case, circumstances may create exceptions to the international minimum treatment rule (Brownlie, 1996: 526; Nwogugu, 1965: 123).

*García-Amador attempted to synthesise the principles relating to the treatment of aliens with the concept of human rights.*¹⁹ Yet his views enjoyed

¹⁸ Brierly (1963: 220) has pointed out that “if a State has a low standard of justice towards its own nationals, an alien’s position is in a sense a privileged one, for the standard of treatment to which international law entitles him is an objective one, and he need not, even though nationals must, submit to unjust treatment”. Schwarzenberger (1948: 402; 1969: 120) has asserted that when there is a conflict between national treatment and the minimum standard of international law, equality of treatment is not enough. Section III 3(a) of the World Bank Guidelines states: “With respect to the protection and security of their person, property rights and interests, and to the granting of permits, import and export licenses and the authorisation to employ, and the issuance of the necessary entry and stay visas to their foreign personnel, and other legal matters relevant to the treatment of foreign investors as described in Section 1 above, such treatment will, subject to the requirement of fair and equitable treatment mentioned above, be as favourable as that accorded by the State to national investors in similar circumstances. In all cases, full protection and security will be accorded to the investor’s rights regarding ownership, control and substantial benefits over his property, including intellectual property.”

¹⁹ García-Amador, a Special Rapporteur to the International Law Commission on the subject of state responsibility, formulated two principles: “1. The State is under a duty to ensure to aliens the enjoyment of the same civil rights, and to make available to them the same individual guarantees as are enjoyed by its own nationals. These rights and guarantees shall not, however,

limited success within the International Law Commission. Nevertheless, it is widely accepted that certain minimum standards based upon human rights principles, such as civil and political rights,²⁰ have become a part of customary international law (Shaw, 1991: 514; Brownlie, 1996: 527-528). However, whether such human rights standards are relevant to the property of an alien in a host State is still uncertain. (Sornarajah, 1994: 131).²¹

11.1.2 Standard of Treatment of Foreign Direct Investment in the ROC

Article 20 of the SIOC and SIFN provide that, “except as provided for in this Statute”, an FIA enterprise shall be legally treated as if it were an enterprise owned and operated by nationals of the ROC. By surmounting the barriers in those statutes, foreign investors effectively overcome the nationality barrier limiting their rights to engage in the mining industry and to own mining fields, to engage in shipping, and civil navigation (Article 18).

However, under the SIFN and SIOC, how and what counts as standard ‘national’ treatment remains subject to debate. For example, a locally owned company would not be subject to reinvestment approval when it invests in another

in any case be less than the ‘fundamental human rights’ recognised and defined in contemporary international instruments. 2. In consequence, in case of violation of civil rights, or disregard of individual guarantees with respect to aliens, international responsibility will be involved only if international recognised ‘fundamental human rights’ are affected.” (*U.N.Y.B.I.L.C.*, 1957, ii, 104, 112-113; García-Amador, Sohn and Baxter, 1974). However, his later works on this issue indicate a change of course; see García-Amador (1990).

²⁰ See, for example, the International Covenant on Civil and Political Rights (adopted in 1966 and entered into force in 1976) and the European Convention for the Protection of Human Rights and Fundamental Freedom (signed in 1950 and entered into force in 1953) (Brownlie, 1995: 276, 328; Shaw, 1991: 199, 221).

²¹ Further on the question of discrimination, see Kronfol (1972: 60-61); Hyder (1968: 20). For other criticism on this synthesis, see Sornarajah (1994: 130-133); Brownlie (1996: 527-528).

company in Taiwan. However, as discussed earlier in Chapter 10.1.3, a foreign investment approved (FIA) company is subject to this requirement, presumably to prevent foreign investors from circumventing the negative listing provisions and policies and the restrictions on investment in listed securities in Taiwan. Simply having to qualify under these statutes distinguishes foreign from domestic investors. The reinvestment requirement itself is a condition imposed on foreign investors in an FIA company in order for them to receive the FIA status, the grant of which is within the discretion of the ROC government. The ambiguity involved in determining national treatment may give rise to uncertainty for foreign investors. It is suggested that the significance of national treatment should be added to the investment laws in order to provide a formal legal assurance for foreign investors. Article 375 of the ROC Company Law might be used as an example:

“A foreign company, after having been given a certificate of recognition, shall have the same rights and obligations and shall subject to the same jurisdiction of the authority as a domestic company, unless otherwise provided by law.”

A significant source of inconsistency with the assurance of national treatment under the SIFN and SIOC is imposed precisely by the conditions a foreign investor must satisfy in return for granting the FIA status. Such conditions often had a significant impact on the operations of the FIA enterprise; such as local equity requirements,²² local contents requirements (LCRs),²³ and export

²² The requirement of local collaboration was, and still is, very common in the former communist Eastern Europe countries, such as Hungary (Pogany, 1989: 56), communist countries in Asia, such as China (Moser 1987; Potter, 1993:1-36; Hsieh, 1993), as well as many developing countries, such as Malaysia (Sornarajah, 1992). In Taiwan, if the foreigner wants to set up a car factory and to sell cars locally, the enterprise must be a joint venture with locals. However, in this case, there is no restriction on the shareholding proportions of the joint venture (Teng, 1991). In cases where the investor wants to establish a rent-lease company, the company must be a joint venture with a Taiwanese bank (Chan, 1990). In principle, the proportion invested by foreign investors cannot be over 70% of the total capital of the enterprise. However, if necessary, it can be raised up to 90% after applying (ibid).

²³ For example, LCRs for production of small cars (except for exporting purposes) under the Car-Industry Development Proposal: initially 70%, reducing to 50%. Manufacturers were required to choose 4 items from a list of 15 items to be produced locally. The aim of this regulation was to promote the car manufacturing technology of component parts in Taiwan (Wang, 1989).

performance requirements (EPRs).²⁴ In recent years, because of trade liberalisation and pressure from trading partners (see Chapter 8 above), these restrictions have been substantially removed by the Government.²⁵ However, where the FIA investor comes from a country, such as Japan, with which Taiwan suffers a substantial trade deficit, such conditions are more likely to be imposed. Japanese investors are thought to be exploitative in Taiwan, and the Government has been considering measures to require Japanese-invested companies in Taiwan to increase exports to Japan in order to reduce Taiwan's trade deficit with Japan (Yue, 1990: 1).²⁶ Although "investment policies are still not free from the vagaries of trade policies" (Liu, 1994 149), the Government should be careful not to violate the principle of equality of treatment. Nonetheless, where the imposition of such requirements are based on the sovereign right of the state to regulate economic activity that takes

Nevertheless, the Government has decreased the level of protection gradually. Another example is the Enforcement Regulation of the Machinery and Electric Products Local Content Scheme, which requires LCRs for motor-cycle production in ROC to be 90% of the whole production input (Teng, 1991).

²⁴ This strategy is quite common in the NIEs. (Of course, there also are instances of developed countries imposing such conditions on foreign investors. For example, the now repealed Foreign Investment Review Act (1972) of Canada required that applications for foreign investment entry should indicate export targets). Apart from the export processing zones, which are specified zones for exporting, there are no other measures in ROC which have restrictions on exporting. In other words, the only EPRs in the ROC are for those who invest in EPZs. According to Article 4 of the Statute for the Establishment and Administration of Export Processing Zones, no product which is for an exporting purpose may be sold locally. However, if the product can not be manufactured in a taxable area and must be imported from abroad, or if any style and quality of the product cannot be manufactured in a taxable area, and it is necessary for productive enterprise or there is any special need in a taxable area, the product can be sold locally after approval by the trade authority-in-charge and it taxed under law. Now, the export processing zones in ROC can be approved, case by case, where the ratio of products to be sold in domestic market are up to fifty percent of the total amount produced (Tang, 1991). Although the United States has argued that export requirements violate standards of free trade, under the Draft Agreement on Trade Related Investment Measures, export requirements are allowed (GATT Doc. MTN.TNC/W/35 Rev.1 20 December 1991).

²⁵ For details of those trade-related investment measures in Taiwan, see Ho (1992) and Liu (1990: 326-343).

²⁶ Note that Japan's trade authorities have also proposed drawing up plans for Japanese firms investing in the Asian NICs to re-export voluntarily to Japan (Wysocki, 1990: 1).

place within its territory and where the Government's distinctions or requirements are made between groups on valid economic or social grounds, it is justifiable.²⁷

The various standards of treatment commonly employed in investment treaties are those of reciprocity, the "open door" standard, good neighbourliness, the identical standard, the national standard, most-favoured-nation (MFN) standard, fair and equitable treatment, and preferential treatment (Brownlie, 1996: 524). Aliens are generally treated according to one or more of the above standards in investment treaties. These, many of these standards can be found in the treaties which Taiwan has concluded with capital-importing countries. For example, Article 3 of the ROC-Nicaragua Investment Guarantee Agreement applied the standard of national treatment:

"the Government of either Contracting Party shall not in its territory subject investments or returns of investors from the other Contracting Party either present or future to treatment less favourable than that which it accords to investments or returns of its own nationals, corporations or other juridical persons or to investments or returns of nationals, corporations or other juridical persons of any third country."

The Agreement is explicit in indicating, in Article 3(2), the areas where national treatment is to be accorded to investments by either Party, including the management, use, enjoyment or disposal of their investments.²⁸

²⁷ This also appears to be the case in Community Law. See *R v. Secretary of State for Home Department ex parte Sheikh Al Sabah* (1992), 2 C.M.L.R. [1992] 676. The Court rejected the argument that equality of treatment required that non-EC nationals and EC nationals should be treated alike in decisions relating to deportation for drug related offences. Also, *Gerhardy v. Brown* (1985), 57 A.L.R. [1985] 472.

²⁸ The authentic English text of Article 3 (2) reads as follows: "The Government of either Contracting Party shall not in its territory subject investors of the other Contracting Party, as regards their management, use, enjoyment or disposal of their investments, either present or future, to treatment less favourable than that which it accords to its own nationals, corporations or other juridical persons or to nationals, corporations or other juridical persons of any third country".

By contrast, Article 4 of the Taipei-Singapore Investment Agreement uses MFN treatment, but only refers to the MFN standard in general terms without indicating its actual operation and scope:

“Neither Contracting Party shall subject investments approved in accordance with the provisions of Article 2 to treatment less favourable than that which it accords to investments or returns of residents and companies elsewhere other than [in] the relevant places”.²⁹

The same ambiguity can be found in Article 4 of the Taipei-Indonesia Investment Protection Agreement but the difference is that this agreement uses both the ‘fair and equitable’³⁰ and the MFN standards:

“Both parties shall seek and obtain the approval of their respective authorities to the effect that all investments made by investors of any party shall enjoy fair and equitable treatment by the other party. This treatment shall be no less favourable than that granted to investors of any third country”.

Although differences between individual bilateral investment treaties “represent a compromise between the inherently divergent interests of the contracting parties” (Pogany, 1988: 155), it is surely preferable to introduce more detailed provisions governing the scope and function of whatever ‘standard of treatment’ is adopted for foreign investments, instead of mentioning the standard in general terms; which tends to confuse rather than clarify the situation.

²⁹ The term “the relevant places” is not found in most bilateral treaties, but it is not unusual in the bilateral treaties Taiwan has concluded with countries it does not have diplomatic relation with. Because of Taiwan’s political status, most countries are reluctant to conclude treaties with Taiwan. Those treaties which Taiwan has concluded are with countries which need Taiwan’s investment. Even in those treaties, the terminology used in articles is carefully chose to avoid any implication of ‘statehood’. For example, in Article 1 of the Agreement Between the Taipei Economic and Trade Office in Thailand and The Thailand Trade and Economic Office in Taipei for the Promotion and Protection of Investments (Taipei-Thailand Investment Protection Agreement), 1996, the term “relevant place” has been defined as “the place of operation to be designated by the respective authorities of the Contracting Parties”.

³⁰ “Fair and equitable” treatment is a vague term and is open to different interpretations. See UNCTC (1988: 30-33). This phrase is used in the Abs-Shawcross Draft Convention on Investment Abroad, 1959 (9 *J.P.L.* [1960] 116) and in the World Bank Guidelines on Foreign Direct Investment, 1992 (31 *I.L.M.* [1992] 1363).

Article 4(1) of the Taipei-Thailand Investment Protection Treaty³¹ uses both the ‘fair and equitable’ and MFN standards, but Article 4 (2) emphasises that MFN should only be accorded on a reciprocal basis:

“All the provisions of this Agreement relating to the granting of treatment not less favourable than that accorded to the investors of any third party shall be granted only on a reciprocal basis”

It is interesting to note that there is a similarity in the bilateral treaties Taiwan has concluded with Singapore, Indonesia and Thailand. These treaties tend to avoid using any term which may result in a protest from the PRC, and avoid any assertion of ‘statehood’ for Taiwan. For example, ‘national treatment’ may be seen to imply that Taiwan is a nation; therefore third-party MFN approaches are preferred in those agreements because “most-favoured-nation” treatment means treatment “no less favourable than that granted to investors of any third country”.

Article 3 of the ROC-Panama Investment Protection Agreement, in blending together ‘fair and equitable’, ‘national’, and ‘MFN’ standards in one clause, provides that either Contracting Party must give fair and equitable treatment to foreign investments; and that this treatment must be at least equal to that granted to nationals or companies of either party, or equal to the treatment granted to nationals or companies of the most-favoured-nation, if the latter is more favourable:

“Either contracting party shall protect within its territory the investments by national or companies of the other contracting party and shall ensure fair, equitable, and non-discriminative treatment to such investment. This treatment shall be at least equal to that granted by each contracting party to its own nationals or companies of the most-favoured-nation, if the latter is more favourable.”

The novelty of this clause is that it blends those standards in one formula, thus giving investors the benefit of either the MFN or the national standard, whichever is the more favourable to them in the particular situation. Such a clause, in effect, widens the standard of treatment by reference to which the lawfulness or

³¹ The treaty was signed on April 30, 1996.

unlawfulness of a State's measures affecting foreign investment can be ascertained. Furthermore, applying two standards concurrently is advantageous, as the benefits of both standards can be enjoyed cumulatively (Schwarzenberger, 1957: 200-207).

From the above discussion, it is clear that, *prima facie*, the ROC adopts the national treatment approach regarding foreign investment protection. Although various standards of treatment can be found in the bilateral treaties which the ROC has concluded, an international minimum standard is not mentioned in any of those treaties. Thus, in the absence of a bilateral investment treaty, it appears that an FIA investor can only claim national treatment according to ROC investment laws; while a non-FIA investor cannot necessarily claim even national treatment, since there is no unilateral guarantee justifiable under domestic law

Investment treaties differ in varying degrees from the ROC's investment laws, especially in the scope of protection and guarantees to foreign investment which they provide. What, then, is the situation when certain terms agreed upon in the treaty depart from the ROC's municipal law?³² What is the status of treaties in the law of the ROC? There is no express provision as to the exact status of treaties within ROC domestic law. In order to consider this question, we first have to examine how treaties can be approved under the ROC laws. Article 58 (II) of the ROC Constitution reads:

"Prior to submission to the Legislative Yüan of any statutory or budgetary bill or any bill concerning martial law, general amnesty, declaration of war, conclusion of peace, treaties, or other important affairs, or concerning matters of common concern to the various ministries and commissions, the President and heads of the various ministries and commissions of the Executive Yüan shall present the said bill to the Executive Yüan Council for discussion and decision."

³² Questions regarding the relationship between international law and municipal law involves two broadly opposing schools of thought: the 'dualist' and 'monist' schools. For discussion of these two schools, see Oppenheim (1996: 53); Shaw (1991: 103). However, it is clear that for the purposes of international law, international legal obligations priority over inconsistent domestic law requirements. See, Brownlie (1996: 35-37).

According to Article 63 of the ROC Constitution:

“The Legislative Yüan shall have to power to decide upon any statutory or budgetary bill or any bill concerning martial law, general amnesty, declaration of war, conclusion of peace, treaties, and other important affairs of the State.”

Therefore, bilateral investment treaties should first be discussed by the Executive Yüan and then concluded by the Legislative Yüan, and such treaties will eventually have legal force like any other statutes in the ROC. The questions will then be: if a treaty provision contradicts an earlier statute, which is to prevail? Similarly, what if a treaty contravenes a later statute? Unfortunately, there is no explicit answer in the laws of the ROC. Article 171 of the Constitution states that: “Laws that are in contravention of the Constitution shall be null and void”, and Article 172 provides that: “Ordinances that are in contravention of the Constitution or laws shall be null and void”. However, the Constitution does not stipulate how to solve conflicts between laws. Therefore, it appears that the general principle *lex posterior derogat priori* should be used when there is a contradiction between a treaty and municipal laws: the instrument later in point of time must prevail (Hackworth, 1943, vol. 5: 185; Mann, 1978: 25-27; Henkin, 1975: 185).

Because most countries were, and still are, reluctant to enter into bilateral treaties with Taiwan, the first bilateral investment treaty Taiwan concluded was with Singapore in 1990 - almost 30 years after Taiwan enacted the SIFN and SIOC. As all the bilateral investment treaties concluded by Taiwan were ratified after the two major investment laws were enacted and indeed after their last amendment in 1989, the former presumably prevail over the latter. This is clearly consistent with the requirements of international law which, as stated above, give priority to international legal obligations over inconsistent rules of domestic law. At the time of writing, there is no case where a conflict is reported to have arisen, and for this reason the present discussion is hypothetical. However, it may not always remain so. If the Government changes its policy from welcoming FDI to excluding FDI,

later FDI laws may create more restrictions on FDI inflows. Those new restrictions may then conflict with existing bilateral treaties, in which case the problem of conflicts between laws will become important.

The intention of the legislature in promulgating the ROC investment laws was to improve the investment climate by furnishing incentives and guarantees to foreign investors (see Part II). To give this policy effective legal force, it is surely necessary to promise foreign investors that rights acquired under previous treaties are to be respected and protected, otherwise, foreign investors will have limited confidence in the application and continuity of the investment laws themselves.

11.2 Expropriation of Foreign Property under International Law and in the Laws of the ROC

The taking of foreign property is a very controversial issue in International Law (Pogany, 1988: 161; Sornarajah, 1994: 277). The controversy extends to various aspects including the concept of 'property', the nature of 'expropriation' and the circumstances under which it is permissible, the way in which the loss should be calculated, and the method of compensation. Many of the questions raised above are still open, and have been addressed by an extensive scholarly literature. It is not proposed to discuss that literature at any length in this thesis. However, it may be helpful to summarise some of the relevant International Law principles before discussing the laws of the ROC.

The taking of foreign property includes expropriation, confiscation and nationalisation. However, because the ROC investment laws use only the term 'expropriation', I will concentrate on expropriation of foreign property under International Law and in the laws of the ROC.

11.2.1 Expropriation of Foreign Property under International Law

Customary international law recognises that the treatment a State accords to aliens on its territory is a matter largely within the discretion of the State. Moreover, the discretion which a State enjoys to exercise its power is not unlimited. The same principle is extended generally to the treatment of the property of aliens in the territory of a State.³³ Therefore, a state's duty to protect aliens also applies to their property (Oppenheim, 1996: 911-912). It is established that a state must respect the property of aliens, and that the aliens have the right to the peaceful enjoyment of their property.³⁴ Nevertheless, a State has the right to determine its structure and may introduce social and economic reforms, including nationalisation or expropriation.

Foreign investors, particularly in developing countries frequently fear the deprivation of their property by the host state without any compensation or with inadequate compensation (ICC, 1959: 5). Deprivation may take many forms.³⁵ 'Expropriation' or 'taking' refers to the transfer of property to the territorial state or to a third party, as might occur with land redistribution in a land reform (Brownlie,

³³ The term 'property' includes physical objects and certain intangible entities, such as debts and intellectual property (Shaw, 1991: 518). 'Incorporeal property', such as contractual rights, has also been included e.g. in the *Liamco Case* (1981) (20 *I.L.M.* [1981] 1, 53; 62 *I.L.R.* 141, 189). See also Article 10 (7) of the 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (55 *A.J.I.L.* [1961] 548).

³⁴ This principle has even been recognised in some human rights treaties. Article 1 of Protocol No 1 to the European Convention on Human Rights, 1954: "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law." (Brownlie, 1995: 341). Also, Article 21 of the American Convention on Human Rights: "1. Everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interest society."

³⁵ For discussion of what constitutes a taking see Christie (1962: 307); Weston (1975: 103); Higgins (1982: 259); Dolzer (1986: 41). In this thesis, I discuss only taking through direct means. For a discussion of indirect taking (creeping expropriation), see Dolzer (1986: 41) and Schwarzenberger, (1969: 18-119).

1996: 531-532).³⁶ ‘Confiscation’ is usually described as an expropriation without compensation (Oppenheim, 1996: 916), or the “taking of property by the ruler or the ruling coterie of the state for personal gain” (Sornarajah, 1994: 278).³⁷ ‘Nationalisation’ is generally referred to as expropriation “with a view to public management in the *national interest*”, including to facilitate social or economic reform (Harris, 1991: 524).³⁸ ‘Sequestration’ or ‘administration’ commonly means that the administration of property is, temporarily or as a prelude to nationalisation, taken over by the state, but that the owner still has title (Oppenheim, 1996: 916).

It is generally accepted that under International Law the expropriation of alien property is not unlawful, provided that certain conditions are met (Shaw, 1991: 517).³⁹ First, the expropriation must not be arbitrary. Secondly, the taking should be for a public purpose. Thirdly, the expropriation should be in accordance with the principle of non-discrimination. Fourthly, ‘prompt’, ‘adequate’, and ‘effective’ compensation should be paid. Although it is controversial whether a

³⁶ Under Article 10(1) and (2) of the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, ‘taking of property’ “includes not only taking of property as outright taking of property, but also any such unreasonable interference with the use, enjoyment, or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference” (55 *A.J.I.L.* [1961] 545-584).

³⁷ In the *BP Case* (1974), the sole arbitrator held that the fact that “no offer of compensation has been made indicates that the taking was also confiscatory” (53 *I.L.R.* [1974] 329).

³⁸ For example, the Mexican expropriations of 1917 and 1938 (Gordon, 1941; Sigmund, 1980).

³⁹ These requirements were exhaustively examined in a series of cases in US courts regarding the operation of Cuban laws enacted in 1960 expropriating US-owned property in Cuba. For example, *Banco Nacional de Cuba v. Sabbatino* (1962), 35 *I.L.R.* [1962] 2, 11, 25; *Banco Nacional de Cuba v. Farr, Whitlock & Co.* (1967), 43 *I.L.R.* [1967] 12. The US courts concluded that the Cuban laws involved an expropriation in violation of international law because of non-payment of compensation, discrimination, and unlawful reprisals. More recently, they have been considered by the chambers of the Iran-US Claims Tribunal in the Hague. See, generally, Mapp (1993).

taking in breach of contractual commitments is unlawful,⁴⁰ where a taking is in violation of a treaty it is normally considered unlawful.⁴¹

(A) The Taking must not be Arbitrary

The concept of ‘arbitrariness’ has been considered in the *Eletronica Sicula Case* (1989). The International Court of Justice stated that ‘arbitrary’ involves “a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety” (*I.C.J. Reports*, 1989: 73-77).⁴² In the *BP Case* (1974), the sole arbitrator considered that Libya’s taking violated international law “as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character” (53 *I.L.R.* [1974] 329).

(B) The Taking must be for a Public Purpose

According to some publicist, an expropriation may be lawful even if no compensation is payable, when it is done for certain public purposes: e.g., an exercise of police power, health measures, or defence measures in wartime (Brownlie, 1996: 536-537). However, whether a public purpose should be treated as a requirement for an otherwise lawful expropriation under International Law is still unclear. Publicists have various opinions,⁴³ and dicta in arbitral awards are by no

⁴⁰ For Nationalisation, expropriation and breach of contract, see Paasivirta (1990: 15-19). See, also, Pogany (1992: 1).

⁴¹ See the *Chorzow Factory Case* (1928). The Court stated that in respect of takings in violation of treaties, restitution was the proper remedy for the international wrong (*P.C.I.J. Reports*, Series A. No. 17).

⁴² The Court also noted that conduct which is unlawful in municipal law is not necessary arbitrary, and that conduct which is arbitrary in municipal law is not necessarily arbitrary in international law (*I.C.J. Reports*, 1989)

⁴³ For support, see Wortley (1959: 24-25); Schwarzenberger (1960: 147); McNair (1959: 243). For opposition, see White (1961: 150), Friedman (1953: 142), Amerasinghe (1967: 138); Metzger (1960: 40).

means consistent.⁴⁴ Furthermore, international instruments put forward different views,⁴⁵ although the requirement continues to be included in almost all bilateral investment treaties.⁴⁶ It is submitted that the 'public purpose' requirement may be used, as 'a motive behind the taking' to distinguish nationalisation from confiscation, and in so doing to supply the exceptional circumstances which justify State intervention.

(C) The Taking must not be Discriminatory

Neither General Assembly Resolution 1803 nor the 1974 Declaration on Economic Rights and Duties of States mention non-discrimination. However, this requirement can be found in many cases decided by international courts and tribunals. For example, in the *Barcelona Traction Case* (1970), the International Court of Justice recognised that the principle against racial discrimination is a rule of *jus cogens* (*I.C.J. Reports*, 1970). The *Saudi Arabia v. Aramco Case* (1963) also

⁴⁴ For example, it was said in the *Case Concerning Certain German Interests in Polish Upper Silesia*, that expropriation must be "for reasons of public utility, judicial liquidation and similar measures" (*P.C.I.J. Series A*, no. 7, 1926: 22). But how far 'public purpose' extends is unclear. In the *BP Case* (1974), the arbitrator found illegality in Libya's act of nationalisation on the ground that the taking "clearly violates public international law as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character" (53 *I.L.R.* [1974] 329). The *Amoco International Finance Corp. v. Iran* (1987) also supports the view that, to be lawful, an expropriation must have a public purpose (15 *Iran-U.S.C.T.R.* 189). But in the *Liamco Case*, the arbitrator dismissed the argument based on the requirement of a public purpose and held that "it is the general opinion in international theory that the public utility principle is not a necessary requisite for the legality of a nationalisation" (20 *I.L.M.* [1981] 58-59; 62 *I.L.R.* 194). In addition, in *Libyan American Oil Co v. Government of the Libyan Arab Republic* (1977), 62 *I.L.R.* 131, 194, public purpose was recognised as relevant only in the context of non-discrimination, which is accepted as a 'clear and undisputed' requisite for a lawful nationalisation.

⁴⁵ In Paragraph 4 of the 1962 General Assembly Resolution on Permanent Sovereignty over Natural Resources, "public utility" is mentioned as a requirement for a lawful nationalisation, expropriation or requisitioning. The requirement of public purpose is also stated in Article 712 (1) (a) of the American Restatement on Foreign Relations Law. (The Draft Restatement of the Foreign Law Relations of the United States dealing with State responsibility for economic injury to aliens was proposed by the American Law Institute: American Law Institute Restatement, The Foreign Law of the US., ss. 190, 197 (proposed official Draft, 1962)).

⁴⁶ For example, Article 6 (4) of the Pakistan-US Treaty of Friendship and Commerce of 1959.

suggests that non-discrimination is a condition of a lawful expropriation (27 *I.L.R.* [1963] 117).⁴⁷ In the recent case of *Siderman de Blake v. Republic of Argentina* (965 F 2d [1992] 699; 79 *A.J.I.L.* [1985] 1065), the US District Court (California) decided that the taking of the property at issue had a “discriminatory motivation based on ethnicity” and full compensation must be paid for the taking.⁴⁸ This requirement has also been endorsed by developed countries including the United Kingdom.⁴⁹

However, a post-colonial nationalisation which is designed to end economic domination by the nationals of the former colonial power is exempt from this general rule.⁵⁰ In Taiwan, this exception would apply only to measures directed at Japanese investors. Even in such a case, however, a question would arise where dual motives of racial hatred and economic objectives together inspired taking, especially when both motives are present in equal strength. It may be that the appropriate response in such a case is to separate the action and the intention: to treat the taking *per se* as a valid taking but “to use the taking as the basis of a separate cause of action based on racial discrimination” (Sornarajah, 1994: 320; Brownlie, 1979: 13).

⁴⁷ See also the *Liamco Case* (1981).

⁴⁸ For discussion of this case, see Dieterich (1985: 594).

⁴⁹ In the *Anglo-Iranian Oil Case (I.C.J. Pleading, p. 81)*, the UK submitted that a “measure of expropriation or nationalisation ... becomes unlawful in international law, if in effect it is exclusively or primarily directed against foreigners as such, and it cannot be shown that, but for the measure of expropriation or nationalisation, public interests of vital importance would suffer”. A similar statement can also be found in the UK and US protests against the Libyan nationalisation.

⁵⁰ For example, a German court accepted the existence of this exception when considering the legality of the Indonesian nationalisation Dutch-owned property (Domke, 1955: 305). See, generally, Sornarajah (1986).

(D) Compensation Rule

It is widely accepted under customary international law that, subject to the constraint outlined above, a State can expropriate and nationalise foreign property situated in its territory, provided that *adequate, effective, and prompt* compensation is paid. The US and most capital-exporting countries support this principle,⁵¹ and the formulation can be found in various draft multilateral codes⁵² and in many bilateral treaties.⁵³ However, capital-importing countries have argued that ‘appropriate compensation’ should be determined by the host State in accordance with its municipal law and practice.⁵⁴ There is no consistent view in UN Resolutions.⁵⁵ Nor is uniformity to be found amongst publicists⁵⁶ or in international arbitral awards.

⁵¹ The formula of “prompt, adequate and effective compensation” was first used by US Secretary of State, Cordell Hull, to the Mexican government, on 21 July 1938, during the Mexican Expropriations. He wrote: “Under every rule of law and equity, no government is entitled to expropriate private property, for whatever purposes, without provision for prompt, adequate and effective compensation.” (Hackworth, [1940-44], vol. 3: 662; Whiteman, vol. 8: 1020). See also Robinson (1984: 176).

⁵² For example, the Abs-Shawcross Draft Convention on Investment Abroad, 1959.

⁵³ For instance, Article 14 of the Anglo-Japanese Commercial Treaty of 1963.

⁵⁴ The best example is in the Article 2 (2) (c) of the Charter of Economic Rights and Duties of States: in the event of expropriation, “appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent” (U.N.G.A., Resolution 3281 (XXIX)). For the view of capital-importing countries, see Somarajah (1994: 402-411); Weston (1981: 437). For analysis of the influence of political and economic factors on the evolution of a new law of expropriation, see Dolzer (1981: 553).

⁵⁵ In the 1962 Permanent Sovereignty Resolution, “appropriate compensation” should be paid for compensation “in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law”. However, the 1974 Charter of Economic Rights and Duties of States emphasises that “appropriate compensation” should only consider domestic laws and regulations. Resolution 3171 (XXVII) also seeks to give each State the sole right to determine the “amount of possible compensation” (13 *I.L.M.* [1974] 238). Similar resolutions have been passed by other United Nations organs. For example, UNCTAD Resolution 88 (11) states that “it is for each state to fix its compensation”.

General terms are frequently employed in national laws, bilateral investment treaties and in other international instruments, as well as in judicial decision. For example, the term “appropriate compensation” has been used in the UN resolutions and can be found widely in case-law.⁵⁷ The requirement of “just compensation” has been used in the Restatement (Third) of the Foreign Relations Law of the United States (American Law Institute, 1987, vol. II: 196). But the crucial question has always been: how is the adequacy, promptness, effectiveness, justness or appropriateness of compensation to be determined, and under what guiding principles? The question of compensation is one of the most controversial issues in international law of foreign investment and is the subject of an extensive literature. Resolution of the issue is beyond the scope of this thesis, and it is proposed here just to mention some of the pertinent international law rules before discussing the laws of the ROC.

⁵⁶ The question of the *standard* of compensation required in cases of expropriation has involved a complex set of conflicting viewpoints. The Hull formula is supported by many Western jurists, such as Domke (1961: 603) and Whiteman (1963: 1085), as reflecting customary international law. However, some writers, such as Schachter (1984: 121-130) and Dolzer (1981: 561), maintain that the Hull formula was never a rule of traditional international law and cannot, in any case, be considered as existing international law applicable to all cases of expropriation of alien property. Some lawyers even maintain that it is “impossible to deduce from the practice of States a legally binding rule according to which owners of property, whether nationals or foreigners, expropriated as a result of [important social] reforms are to be compensated” (Friedman, 1953: 206; Bishop, 1971: 866). Other Western authors, such as Bring (1980: 99-132) and Dolzer (1985: 218-219), have stated that the formula of “appropriate” or “effective” compensation more closely restates emerging consensus in the field. By contrast, under a doctrine upheld by the former Soviet Union, it was maintained that there is no obligation under international law to compensate at all in cases of nationalisation. See Amerasinghe (1967: 143), Seidl-Hohenveldern (1958: 541).

⁵⁷ For example, *Texco Case* (1978) (17 *I.L.M.* [1978] 3, 29, 53; 53 *I.L.R.* 389, 489) and *Aminoil Case* (1982) (21 *I.L.M.* [1982] 976; 66 *I.L.R.* 519).

(i) Promptness

In general, in order to be prompt, compensation must be paid either before the taking or within a short time afterwards.⁵⁸ If payment is delayed, the usual practice is to determine an appropriate rate of interest so that the investor will not suffer further loss (Kronfol, 1972: 110). In the *David Goldenberg Case*, the arbitrator indicated that compensation should be paid “as quickly as possible” (*U.N.R.I.A.A.*, vol. 11: 99), while in the *Norwegian Claim Case*, compensation was to be paid in “due time” (*U.N.R.I.A.A.*, vol. 11: 309). However, in reality, few States have “been in a sufficiently strong economic and financial position to be able to pay the agreed compensation immediately in full” (U.N.I.L.C. Doc. (1959) A/CN.4/119). Therefore, in many instances the payment of compensation provided has been by instalments spread over a period of years. For example, Mexico paid compensation to the US over nine years following Mexican nationalisation (Foighel, 1957: 127).

(ii) Adequacy

Whether compensation is adequate depends on the value to be placed on the property (Oppenheim, 1996: 921). In principle, in order to be adequate, compensation should correspond fully to the value of the foreign investment affected by the nationalisation (Fatouros, 1962: 326).⁵⁹ But, how the actual loss should be valued is problematic in international law,⁶⁰ and the amount of

⁵⁸ For example, “prompt” has been defined in the World Bank Guidelines on the Treatment of Foreign Direct Investment as “in normal circumstances if paid without delay” (Guidelines IV, Section 8) (31 *I.L.M.* [1992] 1383).

⁵⁹ The draft OECD convention (1967) required the payment of full compensation for nationalisation.

⁶⁰ For example, should compensation include the loss of future profits (*lucrum cessans*)? In *Amco v. Indonesia Case*, the Tribunal held that “the *damnum emergens* [loss suffered] and the *lucrum cessans* [expected profits] ... may be considered as a source of international law” (24 *I.L.M.* [1985] 1022). However, in the *Amoco Case* (1987), a Chamber of the Iran-US Claims Tribunal rejected the “discounted cash flow” method and stated that compensation for lost profits was

compensation will involve further consideration on distinguishing between lawful and unlawful expropriation.⁶¹ In principle, the lawful taking involves a duty to pay compensation only for direct losses at the moment of dispossession and the assessment of compensation is based on the fair market value,⁶² while unlawful taking involves liability for expected profits (Shaw 1991: 522-524; Brownlie 1996: 537-539). Although “adequate” (full) compensation has been stipulated in some bilateral treaties and by some developed countries, in practice, full (adequate) compensation seem to be rare and in most cases compensation has been partial and

only applicable in an unlawful expropriation (15 *Iran-U.S.C.T.R.* 246-252). Also in the *Liamco Case*, the sole arbitrator held that the inclusion of future profits in the compensation payable will not be justified (3 *I.L.R.* 138). But, in *AIG v. the Islamic Republic of Iran*, lost profits were awarded in a lawful expropriation (4 *Iran-U.S.C.T.R.* 96-110)

⁶¹ In the *Amoco v. Iran Case* (1987), the Tribunal held that “a clear distinction must be made between lawful and unlawful expropriations, since the rules applicable to the compensation to be paid by the expropriating state differ according to the legal characterisation of the taking” (15 *Iran-U.S.C.T.R.* 189). Also, in the *James and Others Case* (1986), the European Court of Human Rights observed that “Legitimate objective of ‘public interest’ ... may call for less than reimbursement of the full market value” (75 *I.L.R.* [1986] 397; ECHR, Series A, no. 98). In *INA Corporation v. Iran Case* (1985), Judge Lagergren confined full compensation to expropriations which are unlawful, and stated that large-scale nationalisation intended to effect an economic restructuring may not be accompanied by full compensation (8 *Iran-U.S.C.T.R.* 390). Similarly, in the *Sedco Inc v. NIOC* (1986), the award seeks to preserve full compensation for small-scale, single-industry nationalisation (*Iran-U.S.C.T.R.* 181). However, no criterion has been devised for defining either a large-scale nationalisation or a small industry by any tribunal.

⁶² See the *Chorzow Factory Case* (1928) (*P.C.I.J. Reports*, Series A. no. 17) and *INA Corporation v. The Islamic Republic of Iran* (1986) (8 *Iran-U.S.C.T.R.* 380-390; 75 *I.L.R.* [1986] 602-603; 80 *A.J.I.L.* [1986] 181). In the *INA Corporation v. Iran Case*, the term “fair market value” was defined as “the amount which a willing buyer would have paid a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalisation itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares” (8 *Iran-U.S.C.T.R.* 380). Fair market value derives from book value plus speculative items such as goodwill (Lillich, 1972-1987, vol. 1: 96-100). “Book value” was defined in the World Bank Guidelines on the Treatment of Foreign Direct Investment as “the difference between the enterprise’s assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise, representing their cost after deducting accumulated depreciation in accordance with generally accepted accounting principles” (Guideline IV, Section 6). Generally, the developing countries have rejected the market value method, and have used book value instead (Kronfol, 1972: 101-102; Sunshine, 1981).

a lump sum settlement is common (Katzarov, 1964: 349).⁶³ On the other hand, Norton (1991: 488) has claimed that “With the exception of ... *Liamco* [case], every recent arbitral tribunal that has considered the issue has affirmed that customary international law requires a state expropriating the property of a foreign national to pay the full value of that property, measured, where possible, by the market value”.

(iii) Effectiveness

Whether compensation is effective involves the question of transferability into a usable currency. Effectiveness usually refers to the exact form of the indemnity, and especially to the possibility of its immediate utilisation by the recipient.⁶⁴ This means in practice compensation must be paid in a standard international currency.⁶⁵ However, it is possible that payment of compensation may be in the paying state's currency.⁶⁶ Other forms of payment, such as raw materials or other goods, may be also utilised (White, 1961: 205-215).⁶⁷ The requirement that

⁶³ For example, the United States accepted less than full compensation in the Marcona nationalisation (dispute between Peru and the US) (Gantz, 1977: 474). Also, in *AIG v. Iran Case*, the compensation which was awarded (10 million) was almost a quarter of the claim that was made by the foreign party (39 million) (4 *Iran-U.S.C.T.R.* [1983] 96). Often claims were settled well below half the sum that was claimed. For example, US-Yugoslavia (1948) settled at 42.5 %, and Britain-Poland (1948) at 33.33 % of the original claim (Kronfol, 1972).

⁶⁴ For example, “effective” was defined in the World Bank Guidelines on the Treatment of Foreign Direct Investment as “it is paid in the currency brought in by the investor where it remains convertible, in another currency designated as freely usable by the International Monetary Fund or in any other currency accepted by the investor” and “in normal circumstances if paid without delay” (Guidelines IV, Section 7).

⁶⁵ In the *Wimbledon Case*, the Permanent Court of International Justice specified that the compensation paid by Germany “shall be effected in French Francs. This is the currency of the applicant in which his financial operations and accounts are conducted, and it may therefore be said that this currency gives the exact measure of the loss to be made good” (*P.C.I.J.*, Series A, no. 1: 32).

⁶⁶ See *Garrow Claim* (1959) (30 *I.L.R.* [1959] 133). Also the UK-Greece agreement (1929).

⁶⁷ For example, in the *Libyan Oil Case*, compensation was paid in crude oil (17 *I.L.M.* [1978] 1).

compensation which has been paid should be freely transferable or convertible is often found in bilateral investment treaties.⁶⁸

(iv) Justness

“Just compensation” sums up most of the above criteria. It was described in the Restatement (Third) of the Foreign Relations Laws of the United States as “an amount equivalent to the value of the property taken and to be paid at the time of taking or within a reasonable time thereafter with interest from the date of taking and in a form economically usable by the foreign national” (American Law Institute, 1987, vol. II: 197). The term was also used in a defeated proposed amendment for Article 2 (2) (c) of the Charter of Economic rights and Duties of States (14 *I.L.M.* [1975] 262-263).⁶⁹ It is sometimes used in bilateral treaties.⁷⁰

(v) Appropriateness

This is an alternative requirement which, like “just”, tends to summarise other elements. What kind of compensation should be regarded as appropriate? In Section 4 of the World Bank Guidelines on the Treatment of Foreign Direct Investment, “appropriate compensation” is defined as “adequate, effective and

⁶⁸ For instance, Article 4 of the France-China investment treaty of 1984 (24 *I.L.M.* [1985] 550) and Article 8 of the Australia-China investment treaty of 1988 (28 *I.L.M.* [1989] 121).

⁶⁹ The proposed amendment formulated the right to nationalise foreign property in the following words: “Each State has the right ... to nationalise, expropriate or requisition foreign property for a public purpose, provided that just compensation, in the light of all relevant circumstances, be paid”. The amendment was proposed by Austria, Belgium, Canada, Denmark, France, Federal Republic of West Germany, Ireland, Italy, Japan, Luxembourg, Netherlands, United Kingdom and United States, and was defeated by an overwhelming majority, composed principally of developing States.

⁷⁰ For example, the Treaty of Amity between the United States and Iran required the prompt payment of “just compensation” and defined such compensation as representing the “full value” of the property taken. The tribunal in *INA v. Iran* read such value as involving the “fair market value of the shares” (8 *Iran-U.S.C.T.R.* 380). The term “just compensation” can also very often be found in Dutch bilateral investment treaties and is usually followed by references to the requirement to pay the “genuine value” of the investment (Sornarajah, 1994: 362).

prompt” and “based on the fair market value of the taken asset”. In addition, “appropriate compensation” is used in both the Resolution on Permanent Sovereignty Over Natural Resources, 1962 (Resolution 1803) and in the Charter of Economic rights and Duties of States, 1974 (Resolution 3281). The former provides that the appropriate compensation should be made in accordance with both the taking state’s domestic law and international law. But Resolution 1803 does not solve the problem when there is a conflict between the municipal law of the nationalising State and the international law rules concerning the appropriateness of compensation. Resolution 3281, however, provides that compensation for nationalised foreign investment may be paid in accordance with domestic law.

The meaning of appropriate compensation is far from clear under international law. The is evident from the disparities in the practice of States. implication of this is disparity in States’ practice. Politically, it could mean anything from full compensation (including future profits) to no compensation at all when the foreign investor had obviously earned inordinate profits from its investment and the host country did not benefit from the investment (Sornarajah, 1994: 406).

11.2.2 Exemption from Requisition or Expropriation: ROC Municipal Laws and Bilateral Treaties Entered into by the ROC

Usually, the assurances and guarantees against expropriation, nationalisation and similar measures promised unilaterally by a State to foreign investors are found in constitutional clauses, in items of legislation and in official policy statements. The purpose of these devices is to demonstrate the intention of the government to protect foreign investment against arbitrary measures.

Article 15 of the ROC Constitution states: “The people’s right to live, to work, and to the ownership of property shall be inviolate”. According to Article 23,

“All the freedoms and rights enumerated in the preceding Articles may not be restricted by law, except in order to prevent infringement of the freedoms of other persons, to avert an imminent crisis, to maintain social order, or to advance public welfare.” However, the word “people” according to Article 7, means “all nationals of the Republic of China”. This implies that the framers of the ROC Constitution, to all intents and purposes, have confined its protection and guarantees to domestic private property, to the exclusion to foreign property.

An FIA investor in Taiwan is guaranteed by the SIFN and the SIOC against government requisition or expropriation of his investment for 20 years after the commencement of the FIA enterprise’s business, so long as he holds (individually or together with other FIA investors) 45 per cent or more of the total paid-in capital of the enterprise.⁷¹ Where the collective FIA ownership does not reach 45 per cent there is no guarantee against expropriation or requisition. However,

“(1) in case the investor’s investment is less than 45 per cent of the total capital of the enterprise in which he invests, he shall be justly compensated if the government acquires or expropriates the invested enterprise because of national defence needs.

(2) The compensation referred to in the preceding paragraph shall be permitted for outward remittance” (Article 15)

In other words, where expropriation occurs as a result of the need to ensure national defence, “just compensation” shall be paid and may be repatriated.

These provisions pose several questions. First, the circumstances which may constitute “national defence needs” are unclear. Secondly, as the FIA enterprise,

⁷¹ Article 16 of the SIFN: “(1) In case the investor’s investment is 45 per cent or more of the total capital of the enterprise in which he invests, such an enterprise shall not be subject to requisition or expropriation for a period of twenty years after commencement of business as long as the investor continues to hold 45 per cent or more of the total capital. (2) If the investor’s investment is made in conjunction with overseas Chinese investment conforming to the Statute for Investment by Overseas Chinese, and their aggregate amount of investment is 45 per cent or more of the total capital of the enterprise involved, the provision of the preceding paragraph shall still apply”

rather than the FIA investor, would be the entity subject to possible requisition or expropriation, it is not clear that the compensation can in fact be fully repatriated. This is because it is unclear whether such compensation is tax exempt. Finally, what constitutes “just compensation” may be a very subjective matter. Making the protection of foreign investment subject to such vague terms as ‘just’, ‘appropriate’ and ‘reasonable’, as discussed in the previous section, invokes questions which remain unresolved in international law, and in an extreme case potentially provides little or no protection at all. It is very difficult to ascertain degrees of reasonableness and what is ‘appropriate’ or ‘just’ in every case, without specific standards and criteria to clothe these general terms. So far as the legislation is concerned, if expropriation occurs, compensation would fall completely within the unilateral judgement of Taiwan. Had more specific qualifying adjectives been provided, the above uncertainties might have been reduced. Fortunately, these issues have not as yet been tested in Taiwan! Even during military conflicts with the PRC in the late 1950s, no foreign property was expropriated by the ROC government for the sake of “national defence needs”. Although Taiwan has committed itself, as a matter of affirmative foreign investment policy, not to expropriate or requisition foreign-invested enterprises in order to protect its international reputation, legislative assurances are still important for their symbolic meaning and in order to maintain an overtly favourable investment environment.

Even apart from issues of compensation under municipal law, unilateral guarantees are not usually sufficient protection for private investment because their continuance depends upon the Government continuing to adhere to the policy manifested in the investment laws. It is therefore important to also have guarantees included in bilateral investment treaties. Examining the fifteen bilateral investment

treaties which Taiwan has concluded so far,⁷² requirements that expropriation must be for a “public purpose” and compensation must be “freely transferable” are found in all of these treaties. However, there is divergence in the standard of compensation. For example, “compensation should be adequate, effectively realisable, made without delay” under the Taipei-Thailand Investment Protection Treaty. But “compensation shall be effectively realisable and shall be made without unreasonable delay. Such compensation shall be the value immediately before the expropriation” under the Taipei-Singapore Investment Protection Treaty. The terms “just and effective compensation” and “market value” are found in the ROC-Paraguay Investment Guarantee Treaty, whereas the term “real value” occurs in the ROC-Panama Investment Protection Treaty. The formulation included in particular treaties on such matters as compensation reflects the fact that Taiwan has negotiated with States in widely varying economic and social situations.

11.3 Repatriation Privileges under the ROC Investment Laws and under the Bilateral Treaties

In order to protect their balance-of-payments position, many countries, especially developing countries, restrict capital outflows and international financial transactions in addition to exports and imports.⁷³ The purpose of foreign exchange control is to effect more efficient utilisation of scarce exchange resources so as to maintain internal and external economic stability (Wang, 1985: 125). Customary international law recognises the right of control by a State over its currency as an

⁷² Taiwan has concluded bilateral investment treaties with Singapore, Indonesia, Philippines, Panama, Paraguay, Nicaragua, Latvia, Malaysia, Vietnam, Argentina, Nigeria, Malawi, Honduras, Thailand, Salvador.

⁷³ For example, Sudan (El Sheikh, 1984: 48-51), India, Brazil and Argentina (Pennington, 1968: 612-614).

attribute of sovereignty.⁷⁴ In the *Tabar Claim (No. 3)*, it was held by the United States International Claims Commission that

“international law and the usual commercial treaties are no bar to exchange restrictions. So long as the control measures are not discriminatory, no principle of international law is violated” (20 *I.L.R.* [1953] 242).

Nevertheless, stringent foreign exchange controls which restrict the remittance of profits and capital will hamper the flow of foreign investment to Taiwan. Such controls not only restrict the remittance of earned profits or the repatriation of capital, but also affect foreign enterprises by making it difficult to employ foreign technicians and managerial personnel because of limitations imposed on the transfer of their salaries abroad. In addition, the operation of the foreign enterprise itself may turn out to be difficult or impossible because of restrictions on importing equipment, machinery and spare parts. Acknowledging this, the Government finally agreed to relax its controls in 1987 (see Chapter 8 above).⁷⁵

The privilege of repatriating profits is probably the most important entitlement for qualified FIA investors in Taiwan. The SIFN specifically permits an FIA investor to repatriate in foreign exchange the annual income, net profits, or interest accrued from the foreign investor's investment in the FIA enterprise. An FIA investor may also repatriate in foreign exchange the invested capital or capital gains one year from the commencement of the business operation of the FIA

⁷⁴ Confirmed by the Permanent Court of International Justice in the case of *Serbian and Brazilian Loans* (1929) (*P.C.I.J.* Series A, No. 20-1, 1929: 44).

See Mann (1982: 485); Nwogugu (1965: 18); Fatouros (1962: 48); Hyde (1956: 690-692).

⁷⁵ When the SIFN was first enacted, capital gains could not be repatriated out of Taiwan. The SIFN was then amended to permit some forms (but not others) of capital gains to be remitted abroad. For instance, a tracing rule had been applied so that if some capital gains were derived from a disposition of land, then that portion of the capital gains representing the realised land appreciation could not be repatriated. For discussion of the process of liberalisation of foreign exchange control, see Part II of this thesis.

enterprise (Article 12 of the SIOC and Article 13 of the SIFN).⁷⁶ It may be asked, however, under the current economic policy of liberalisation and internationalisation, what is the value in requiring a one year lock-up period during which the original FIA investment capital cannot be repatriated from Taiwan? This device certainly does not improve Taiwan's investment environment. It is therefore submitted that the lock-up requirement should be deleted in the next investment law reform.

As discussed earlier, the Outward Regulations provide that any ROC natural or juridical person may remit abroad up to US\$ 5 million annually, without the need for supporting documentation to be presented to the CBC for approval. Although foreign investors may also take advantage of a repatriation privilege under the Outward Regulations, the latter privilege is granted only as a *regulatory* measure. In other words, the accorded rights are administrative law rights and the amount of foreign exchange which may be remitted freely can be reduced or withdrawn by the administrative agency in accordance with Government policy. Although some foreign investors have chosen to bypass the FIA route in setting up their profit-seeking operation in Taiwan, most still seek to obtain the *statutory* repatriation privilege under the SIFN wherever they can.

It is obvious that the purpose of bilateral investment treaties is to protect foreign investors' interests. However, the weakness of these treaties is that the obligations they impose on the host country are general in terms, and unjustified interference with foreign investments can usually be excused under the reservations made to the obligations. For example, Article 5 of the Taipei-Indonesia Investment Protection Agreement states:

⁷⁶ The privilege of repatriating the original investment under the SIFN, however, is not a simple right. Under the Company Law a foreign shareholder should cause the Taiwan company to be liquidated and dissolved in order to retrieve the original paid-in capital.

“Both parties shall seek and obtain the approval of their respective authorities to the effect that individuals or companies of either party shall have the right of free transfer of their capital and of the returns from it, subject to the right of each party in exceptional financial or economic circumstances to exercise equitably and in good faith powers conferred by its existing laws and regulations when this Agreement enters into force.”

The definitions of ‘exceptional financial’ or ‘exceptional economic circumstances’ admit discretion,⁷⁷ and are capable of being manipulated by the host country as an excuse to control the movement of foreign exchange. In order to avoid this defect, Article 8 of the Taipei-Singapore Investment Protection Agreement provides that investors will obtain compensation from the host country when the right of repatriation of investment is affected (within the territory of the host country), regardless of the reasons for which the host state suspends that right:

“1. Residents and companies of either relevant place shall be accorded free transfer on a non-discriminatory basis, of their capital, earnings, and returns from any investments and assets in the other relevant place.

2. In the event of the occurrence of inconvertibility in either relevant place, residents and/or companies of the other relevant place may invoke the convertibility rights and transfer their blocked local currencies to the account of the Contracting Party or any other account designated by the Contracting Party or an agency or instrumentality thereof to compensate the damages resulting therefrom. The said Contracting Party may then present those local currencies to the other Contracting Party for remittance in the form of a convertible foreign currency as compensation.”

Therefore, although it seems that the legitimacy of *bona fide* restrictions on currency exchanges, when made for the public interest, cannot be challenged internationally even if they cause loss to foreigners,⁷⁸ bilateral investment treaties,

⁷⁷ The same clause can be found in many British treaties, e.g. the Singapore-UK Investment Treaty. Such escape clauses are also found in US and other nations’ treaties. The IMF Articles of Agreement permit exchange restrictions in times of financial difficulties. In some British treaties, such as the UK-Guyana Treaty, there is a requirement that the repatriation of a percentage of the profits (usually 20 per cent) should be permitted every year in circumstances of foreign exchange difficulties. This creates an obligation to permit the repatriation of at least a percentage of the profits and the rest when circumstances permit.

⁷⁸ In the case of *re Helbert Wagg & Co.*, it was held that English courts will not recognise a foreign exchange law which is not *bona fide*, but was passed “in reality with some object not in accordance with the usage of nations” (1 All E.R. [1956] 129; 22 *I.L.R.* 481). This principle has been impliedly recognised by the OECD Draft Convention on the Protection of Foreign Property of OECD (1962) (Publication no. 15637) (2 *I.L.M.* [1963] 241). Note that the text and the commentary attached to the Draft Convention were modified and adopted in 1967 (Resolution no. 23081) (7 *I.L.M.* [1968] 117; Cmmd. 1257 (1960)).

despite the weakness identified above, can often provide a better degree of assurance and protection to investors than a unilateral guarantee from the host country.

11.4 Other Privileges under the ROC Investment Laws

We have seen in this thesis that FIA status accords the foreign investor with various rights, privileges, and entitlements within Taiwan. Apart from the guarantee of entitlement to the rights of nationals, exemption from expropriation and requisition, and privilege for repatriation, which have been discussed in this chapter, there are other privileges which FIA investment can enjoy under the ROC investment laws. These include the privilege of making inward remittances, together with exemption from government requirements such as the mandatory employee subscription right, the duty to make a public issue of shares, and restrictions concerning corporate governance matters, as well as the ability to transfer approved foreign investment.

11.4.1 Advantages under the Regulation for Non-Governmental Inward Remittances

As discussed in Chapter 8.1.1 and Chapter 9.1.2, the liberalisation of foreign exchange control has largely reduced the significance of obtaining an FIA status for a foreign investment project. However, one advantage in obtaining the FIA status is that the FIA investor will be guaranteed the right to remit foreign exchange funds into Taiwan for conversion into NT dollars under the Inward Regulations in order to fund the paid-in capital of the FIA company. Because the guarantee is granted by a *statutory* authorisation, it gives more legal assurance to the investors than a *regulatory* measure such as the Regulation for Non-Governmental Inward Remittances (Inward Regulations) which has the status of secondary legislation.

Although a non-FIA investor has a US\$ 5 million annual quota for inward transfers under Article 4 of the Inward Regulations, the foreign investor must have a Foreigner's Residence Certificate (see Chapter 10.2.1(B)(ii) above) in order to qualify as a recipient. Therefore, without an FIA, the foreign investor, who often is not resident in Taiwan, would not have the right of inward remittance and conversion in order to fund the investment in Taiwan with NT dollar-denominated funds.

11.4.2 Exemption from Mandatory Employee Subscription

The SIFN and SIOC also exempt an FIA enterprise which has 45 per cent or more collective FIA ownership from the mandatory employee subscription right.⁷⁹ This is an important exemption, as it assures the ability of foreign investors to control the FIA enterprise as it expands. The exemption is particularly popular for the FIA investor who owns a small company or who is an individual.

Under Article 267 (I) of the Company Law, when a company limited by shares issues new shares for cash it must allocate 10-15 per cent of the shares to be issued to employees for their subscription at the same price.⁸⁰ This provision is the dominant feature of employee stock-option arrangements in Taiwan. Thus, whenever new shares are issued, unless the new shares represent capitalisation of retained earnings or capital surplus, the employer's ownership will gradually be diluted through the exercise of such subscription rights. Because it is virtually

⁷⁹ Article 18 (II) of the SIFN and SIOC: "In case an investor's investment is 45 per cent or more of the total capital of the enterprise in which he invests, the provision of Article 156 (IV) of the Company Law requiring issuance of stock certificates to the public, and the provision of Article 267 of the same Law requiring setting aside a certain percentage of new shares to be issued for purchase by the employees of the invested enterprise shall not be applicable."

⁸⁰ Article 267 (I) of the Company Law: "Unless otherwise approved specifically by the central authority in charge of the object enterprise, when a company issues new shares, there shall be ten to fifteen per cent of such new shares reserved for subscription by employees of the company."

inevitable that a successful company will in time need to make a cash offering in order to increase its paid-in capital, in practice this has been a very important concession to FIA investors.

However, since the 1987 liberalisation, Taiwan's securities market has begun to increase its trading volumes and market capitalisation, and this exemption has become slightly less significant. Some FIA investors have chosen to waive the SIFN exemption and to transfer a minority interest to their employees in order to keep quality employees within the company. Some companies, such as Wang Laboratories, Inc., have even decided to take their subsidiary in Taiwan public.⁸¹ This strategy enables them to raise funds by taking advantage of the higher price/earnings ratios of listed companies in Taiwan.⁸² It is also a useful technique in the management of higher wages, labour awareness, and mobility. There are now a significant number of FIA companies with employee ownership (Liu, 1994: 146).

11.4.3 Waiver of Requirement to Go Public

Under Article 156(IV) of the Company Law, companies with a certain amount of paid-in capital must issue their shares to the public (i.e. list their shares in Taiwan's securities market).⁸³ The threshold for a company to go public according to the MOEA is NT\$ 200 million. The rationale for having this requirement is to counteract the prevalence of family ownership and holdings in closed companies. However, an FIA company is exempt from the requirement to go

⁸¹ For more information about Taiwan's securities market, see Hsu and Liu (1988, 169).

⁸² Some American firms have successfully applied this strategy in the Japanese securities market, in which listed companies enjoy similarly higher price-earnings ratios (Chandler, 1990: 1).

⁸³ Article 156 (IV) of Company Law: "When the capital of a company has reached or exceeded a specific amount fixed by the central authority, its share certificates shall be issued in public, unless otherwise approved by the central authority in charge of the object enterprise."

public, provided it has a collective FIA ownership of 45 per cent or more of its paid-in capital of the FIA company (Article 18 of the SIFN and SIOC).

Unlike the employee subscription right, the requirement to go public under the Company Law has long been problematic. Under the Securities and Exchange Law,⁸⁴ those companies with more than NT\$ 200 million of paid-in capital should file a definitive prospectus to the Securities and Exchange Commission (SEC) and be subject to the continuous disclosure requirements. Because this is a complicated procedure and because most companies are reluctant to disclose their financial information to the Government, a significant number of companies have deliberately kept their paid-in capital slightly under NT\$ 200 million in order to avoid the requirement of going public. The exemption from the requirement of going public under the Company Law and the SEL is therefore very valuable to FIA investors with large investments in Taiwan, who generally do not wish to be subject to either mandatory dilution or continuous disclosure of financial and other information to the SEC.

11.4.4 Waiver of Certain Corporate Governance Requirements

Article 18 (I) of the SIFN and SIOC stipulates that an FIA company is exempt from certain Company Law provisions relating to domicile, nationality, minimum shareholding by ROC nationals, and to nationality and domicile requirements with respect to the chairman of the board of directors and the supervisors.⁸⁵ Also, if an FIA company has all its shareholders outside Taiwan, it

⁸⁴ Promulgated on April 30, 1968. Amended on November 13, 1981, May 11, 1983, and January 29, 1988.

⁸⁵ Article 18 (I) of the SIFN and SIOC: "For an invested enterprise organised as a company according to the Company Law, the investors may be exempt from the restrictions concerning domicile in Chinese territory, Chinese nationality, and amount of investment contained in Article 98 (I), 108 (II), 128 (I), 208 (V) and 216 (I) of the same law."

will normally be permitted to hold its board of directors' and shareholders' meetings abroad.

This exemption bypasses restrictions in the Company Law which were installed to ensure Chinese control of companies incorporated under the Company Law. In China, the first law regulating companies (known as "*Kung-ssu Lü*") was promulgated in 1904⁸⁶ when it was perceived that there was undue foreign influence in Ch'ing China and that disadvantageous treaties had been concluded with the West (see Chapter 3 above). Such a rationale is no longer applicable in circumstances where foreign investment is positively encouraged, and this exemption reflects a quasi-national treatment of FIA investors in Taiwan companies; the corporate governance of these FIA companies should not now be restricted in such a way as to defeat the purpose of allowing FIA investment in Taiwan.

11.4.5 Ability to Transfer Investment Entitlements

As discussed above, in Chapter 11.3, FIA investors enjoy a repatriation privilege under the ROC investment laws. The SIFN and SIOC specifically prohibits any assignment of this repatriation privilege, an entitlement personal to the FIA investor, except to his legitimate heirs and successors (Article 12).

⁸⁶ Enactment of the *Kung-ssu Lü* was one of the most important achievements in a series of law reforms that occurred during the closing years of the Ch'ing Dynasty. A statute entitled "*Shang Jen Tung Lü*" (General Regulations Governing Merchants) was enacted at the same time and was a related statute to the "*Kung-ssu Lü*" (Hung, 1932: 10-11). The law reform was an attempt to modernise and thereby maintain the Empire which was collapsing under the severe internal pressures generated by foreign powers (Li, 1960: 171). The 131 articles of the *Kung-ssu Lü* were primarily transplanted from the Japanese Commercial code of 1899 and secondarily from the English Companies Act. As such, it was a hybrid of the civil system and the common law system (Lai, 1985: 754). Since the establishment of the ROC in 1912, an unceasing effort has been made to amend and update the Code. The Government use the new term "*Kung-ssu Fa*" (Company Law) to replace "*Kung-ssu Lü*" and has revised the Company Law for 11 times by the time of writing. For detailed discussion of the revision, see Liu (1974: 9) and Yang (1980: 1-14).

However, an FIA investor may apply to transfer all of its entitlements under an existing FIA to another foreign investor. Under this ‘investment transfer FIA’, the repatriation right can be assigned to the new FIA investor who takes over the former FIA investor’s approved investment in Taiwan.⁸⁷

Most transfers under such circumstances involve the sale, transfer, or other disposition of the shares in the FIA company by the former FIA investor. Under the Company Law such transfer will be valid as between the transferor and the transferee when the stock certificates are delivered and duly endorsed, and is binding upon the company when the new shareholder registers his name on the shareholders’ roster maintained by the company.⁸⁸ When the transfer is between two foreign investors, the transfer is likely to be paid for outside Taiwan. However, failure to obtain an FIA approval with respect to the share transfer may result in the forfeiture of the former FIA investor’s repatriation rights.⁸⁹ The transferee would not be protected either, since the transfer would make him a non-FIA investor not entitled to advantages accorded by the SIFN and SIOC.

⁸⁷ Article 12 of the SIFN and Article 11 of the SIOC: “The investor shall be entitled to exchange settlement in accordance with the provisions of this Statute. This privilege is not transferable except to his legitimate heir or to other authorised foreign nationals or overseas Chinese to whom he has assigned his investment.”

⁸⁸ Article 164 of the Company Law: “Registered share certificates may be transferred by endorsement of the holder thereof.”

Article 165 (I) of the Company Law: “The transfer of registered share certificate shall not be set up as a defence against the company unless the true name or title of the transferee is inscribed in the share certificate and the true name or title and domicile or residence of the transferee are entered in the shareholders’ roster”.

⁸⁹ Article 22 of the SIFN and Article 24 of the SIOC: “If the investor violates the provisions of this Statute or fails to perform any matters approved by the Investment Commission, unless otherwise provided for in this Statute, the Ministry of Economic Affairs may deal with the situation in the following manner. 1. To revoke the right for exchange settlement against the income of net and interest accrual for a prescribed period of time. 2. To revoke the investment case and those rights conferred by this Statute.”

11.4.6 Exemption from Sectoral Investment Restrictions

Upon obtaining special approval from the Executive Yüan, an FIA company will no longer be subject to the domicile and nationality requirements contained in the Mining Law, Land Law, Maritime Law and Civil Aviation Law. With special approval by the Executive Yüan, the FIA investor or FIA enterprise may invest and engage in certain business operations in the sectors of mining, land, navigation, and civil aviation, which are not otherwise open to foreign investment.

11.4.7 Favourable Treatment on Dividend Withholding Tax

Under Article 11 of the SUI, a non-resident foreigner's and foreign business enterprise's withholding tax for dividend distributed by the company is 20 per cent (Article 16).⁹⁰ However, if the investments are not FIA-approved in accordance with the SIOC and SIFN, the withholding tax is set at 35 per cent, the same as for an ROC natural person. This distinction between FIA and non-FIA investment was made in the SEI (and retained in the SUI when SEI expired in 1990) described in Chapter 7.2.2, it provides a big tax-rate disparity between FIA and non FIA investments, being designed to direct FDI toward preferred industries and to keep FDI under the control of specific FDI laws.

⁹⁰ Article 11 (I) of the SUI: "When a non-resident individual or a non-resident profit-seeking enterprise, having been approved to make investment in the Republic of China under the Statute for Investment by Overseas Chinese or the Statute for Investment by Foreign Nationals, receives dividend distributed by a company located in the Republic of China or profit distributed by a partnership in the Republic of China, the income tax payable thereon by such individual or enterprise shall be withheld at the time of payment thereof by the tax withholder as specified in the Income Tax Law at the rate of twenty per cent of such distribution, and the provisions provided in the Income Tax Law for filing final income tax return shall no apply."

11.5 Settlement of Investment Disputes

Foreign investment in Taiwan is regulated by municipal laws, treaties, and other similar instruments such as administrative orders; and these regulatory instruments grant extensive incentives, concessions and some protection to foreign investors. Occasionally, disputes may arise from the practical application of these incentives or in the interpretation of the rights and obligations of the parties. Because the existence of effective remedies may reduce the likelihood of hostile measures against foreign-owned property (Pogany, 1988: 51), it is therefore important to consider the nature and extent of the remedies available to foreign investors in Taiwan. In this section, the methods of settlement of investment disputes under international law will first be briefly introduced as a standard of comparison. However, because of the unusual situation of Taiwan, i.e. it has been excluded from the World Bank, MIGA and from other international organisations and multilateral treaties, this has significantly limited the range of facilities and techniques available for the settlement of an investment dispute where the investment is located in Taiwan. Thus, the next section will examine only the ROC's implementation of the International Convention on Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), with emphasis on the technical problems between the ROC government and foreign investors. Finally, dispute settlement methods provided for in bilateral investment treaties concluded by Taiwan will be considered.

11.5.1 Settlement of Investment Disputes under International Law

(A) Methods of Settling Investment Disputes in International Law

It is recognised that there is no obligation in customary international law to settle disputes, and procedures for settlement by formal and legal procedures rest on the consent of the parties (Brownlie, 1996: 708). Generally speaking, there are two

categories of disputes settlement: diplomatic procedures and adjudication (Shaw, 1991: 629). The former are regarded as informal methods of settling disputes, including investment disputes, and they include diplomatic intervention, negotiation, good offices, and mediation (Brownlie, 1996: 709). The latter are regarded as formal methods of settlement, and include decisions by courts such as the International Court of Justice, the awards of *ad hoc* arbitral tribunals, of mixed commissions, and of specialised tribunals of a semi-permanent character (Mosler and Bernhardt, 1974: 83-190, 285-416).

Arbitration has been an important device for the settlement of investment disputes. The practice of arbitration evolved as a sophisticated procedure similar to judicial settlement (Brownlie, 1996: 709). There are two types of arbitration: one is international institutional arbitration, such as by the International Chamber of Commerce (ICC),⁹¹ the Permanent Court of Arbitration (PCA),⁹² and the International Centre for Settlement of Investment Disputes (ICSID); the other is *ad hoc* arbitration.⁹³ The latter category may be subdivided into national and

⁹¹ Disputes referred to ICC arbitration must be “business” disputes. Particularly, this would include transactions and operations involving international trade and economic co-operation in public works agreements for developing areas and investment contracts (Kronfol, 1972: 140).

⁹² The Permanent Court was an offspring of the Convention for the Pacific Settlement of International Disputes signed at the Hague on 29 July 1899. This Convention was revised and replaced by the 1907 Convention of the same title concluded at the Second Peace Conference at the Hague (Scott, 1972: 57). The PCA is actually neither a court nor a permanent institution. It is merely a panel of arbitrators, members of which may be called to act as an arbitral tribunal. Between 1900 and 1932, 20 cases were heard by the PCA, but no cases have been dealt with since then (Brownlie, 1996: 710).

⁹³ *Ad hoc* arbitration is frequently provided for in bilateral investment treaties which provide for the settlement of disputes which may arise between the parties on the treaties’ application or interpretation. They usually give precedence to consultation between Governments as a first step towards any settlement (e.g. Article 11 (1) of the German-Pakistan Investment Treaty and Article 9 of the Taipei-Indonesian Investment Treaty) (Kronfol. 1972: 136). If a dispute cannot thus be settled, the treaty normally goes on to provide how the arbitrators are to be appointed, if the parties fail to agree on the appointment. Reference is usually made to the President or Vice-President of the International Court of Justice to make the necessary appointment (e.g. Article 10 of the Sudan-Swiss Agreement).

international arbitration. In addition, the technique of Conciliation can sometimes be found in investment treaties for settling disputes; it is sometimes described as having a “semi-judicial aspect” (Brownlie, 1996: 709).

(B) The Settlement of Investment Disputes in Bilateral Investment Treaties

It is accepted that, under customary international law, foreign natural and juridical investors lack international legal personality. This is because, generally speaking, States are regarded as subjects of international law whereas individuals or companies are regarded as mere objects. Consequently, investors cannot bring a claim before an international tribunal without the consent of the host state (Brownlie, 1996: 67-69; Pogany, 1988: 164). This creates tremendous difficulties for investors when the domestic law of the host state does not provide an adequate remedy for a foreign investor and the home state is unwilling, or unable, to take up a claim on their behalf. However, bilateral investment treaties can enlarge the scope of foreign investors’ remedies. Particularly in the context of arrangements with States, disputes are normally resolved through negotiations. In case negotiations fail, the courts of the host State will normally have jurisdiction over disputes arising out of investments made in that country. In most treaties, exhaustion of local remedies is required before any recourse is had to international arbitration (Shihata, 1986: 1; Amerasinghe, 1990: 257-266; Westberg and Marchais, 1993: 353).⁹⁴ However, it is usually possible for States and foreign investors voluntarily to refer their difference

⁹⁴ However, the requirement of exhaustion of local remedies is sometimes dispensed with by treaty. For example, claims heard by the US-Mexican General Claims Commission did not have to satisfy this rule. In the *ELSI Case*, it was held by the International Court of Justice that such an “important principle of customary international law” could not be held to have been “tacitly dispensed with” (*I.C.J. Reports*, 1989: 15).

to alternative mechanisms such as conciliation or binding arbitration. Thus, international arbitration is no longer the privilege of States.⁹⁵

Normally, disputes arising under bilateral investment treaties include 'investment disputes' (i.e. disputes between a host State and an investor of the other State concerning an investment) and disputes between the contracting parties themselves concerning the interpretation or application of the treaty (Pogany, 1989: 51). In the case of ICSID, the conciliation and arbitration facilities of ICSID are only available for the settlement of disputes between States and nationals of other States provided both the host State and the home State are parties of the ICSID Convention; disputes between States over the interpretation of bilateral investment treaties provisions are, in all cases, referable to other international systems of arbitration (Khalil, 1993: 264).

11.5.2 Investment Disputes Settlement in the ROC

Under the influence of Confucianism, the Chinese traditionally consider that lawsuits are a disruption of social harmony, and view them as a regrettable necessity rather than as an admirable means of settling disputes (MacClelland, 1985: 11; Hsiao, 1994: 9).⁹⁶ One consequence of this, domestically, is that Chinese

⁹⁵ There are precedents, such as the 1922 Polish-German Convention relating to Upper Silesia, which empowered individuals to bring certain claims before an international tribunal. See *Steiner and Gross v. Polish State Case* (4 *Annual Digest* [1927-28] vol. 4: 291).

⁹⁶ Before the importation of Western law and a Western legal system, China had its own conception of law and means for the administration of justice (disputes settlement), which prevailed in the general traditional culture for thousands of years. To understand why the Chinese do not like litigation for dispute settlement, it is essential to understand the development of two different concepts, namely, *Fa* and *Li*. *Fa*, literally meaning law, was restricted to measures and provisions having to do with crime and punishment. *Li* is often interpreted as rites, good customs, mores, or propriety and covered a wide range of rules of individual and social conduct, regulating, in large part, what today is understood as civil matters (Sang, 1992: 417-418). Because Confucius (551-479 B.C.) and his followers advocated *Li*, *Li* eventually dominated *Fa* or law as Confucianism became the authoritative doctrine of China during the first century B.C. As a result, law was, primarily, to support and uphold the teachings and institutions of *Li* and hence became highly ethics-oriented. As another result, law in fact only played an inferior role in maintaining peace and order in traditional China (Ch'ü, 1965). This

society offers a favourable climate for dispute settlement: informal dispute settlement procedures, such as negotiation and mediation, have been the most popular methods for Chinese people. Litigation or arbitration is very much regarded as a last resort (Huang, 1946: 219-221; Caldwell, 1992: 101). This psychological factor should not be overlooked in examining the ROC Statute on the settlement of investment dispute.

Because of Taiwan's political status, it is neither a member of many important international organisations nor a party to many multilateral treaties. Indeed, the only important convention regarding FDI to which Taiwan is a party is the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.⁹⁷ The ICSID Convention was ratified by the ROC under the Statute Governing the Enforcement of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1968 (hereinafter referred as the Statute Governing the ICSID Convention).⁹⁸

had a lingering impact on the thought and action of the Chinese people. For instance, even today, it is often extra-legal standards, formerly known as *Li*, rather than formal law that the Chinese people in general would look up to as accepted criteria of social behaviour. However, there is no denying that increasing international trade and foreign investment in the past three decades have brought about considerable changes concerning the ideal of and attitude toward law both on the part of the government and the people in the Chinese society in Taiwan (Ma, 1971).

⁹⁷ The ICSID Convention came into force on 14 October, 1966. 575 U.N.T.S. 159; 4 *I.L.M.* (1965: 532); U.K.T.S. (1967: No. 25) or Cmnd. 3255; 17 *United States Treaty Series* 1270; *Treaties and Other International Acts Series*, p. 6090; Centre document ICSID/2; 60 *A.J.I.L.* (1966: 892); *Investment Laws of the World*, vol. 1. For the negotiation history of the ICSID Convention, see Schwarzenberger (1969: 135-138)

⁹⁸ The Statute Governing the Enforcement of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States was promulgated on December 21, 1968.

(A) The ROC Laws Implementing the Convention on Settlement of Investment Disputes between States and Nationals of Other States

(i) Jurisdiction

(a) Nature of the Dispute

Article 2 (4) of the Statute Governing the ICSID Convention states:

“The term ‘dispute’ means *any legal dispute* between the government of the Republic of China and a foreign investor, directly arising out of an investment, and directly affecting the right or obligation of the party to the dispute to be enjoyed or fulfilled in accordance with the law or laws of the Republic of China, or relating to the nature or scope of compensation to be paid by one of the parties to the dispute for non-fulfilment of his legal obligation.”

It is clear that the investment dispute must be a “legal dispute” to be within the jurisdiction of ICSID.⁹⁹ As well as this, however, it must be a dispute “arising out of an investment”. Article 2 (3) of the Statute Governing the ICSID Convention states that “investment” means an investment “approved under the provisions of the Statute for Investment by Foreign Nationals” which is “operative in any type of business as defined in Article 3 of the Statute for Encouragement of Investment”. A number of questions arise. First, the Statute for Encouragement of Investment had been replaced by Statute for Upgrading Industry after 31 December 1990 (see Chapter 8 above). How can Article 2 of the Statute Governing the ICSID Convention be applied when it is based on a regulation that is no longer in force? Obviously, the Statute Governing the ICSID Convention is out of date and needs to be revised. Secondly, the Statute Governing the ICSID Convention excludes investments made by overseas Chinese under the Statute for Investment by

⁹⁹ Article 25 (1) of the ICSID Convention provides: “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of and investment, between a Contracting State (or any constituent subdivision or agency of a contracting State designated to the centre by that State) and a national of another contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.”

Overseas Chinese. It is unclear why this is the case, and it seems unjustifiable that investment disputes arising between overseas Chinese and the ROC government cannot be submitted to ICSID. This point will be considered further below. Thirdly, a definition of “legal dispute” is absent from the statute. The term would presumably exclude disputes which are political in nature or which arise from differences in priorities between the parties. But its precise extent is uncertain.

It is also noted that, instead of giving any general definition, the term “investment” is defined in the Statute Governing the ICSID Convention by reference to practical criteria. Thus the concept of “foreign investment” for the purposes of dispute settlement may be different from the more general concept which was discussed in Chapter 10.

(b) Identity of the Parties

The only governmental party recognised by the Statute Governing the ICSID Convention is the central government of the ROC.¹⁰⁰ This narrows the range of parties allowed under the ICSID Convention, Article 25(1) of which specifically includes within its coverage any municipal government, ministers or agencies.¹⁰¹

A qualifying foreign investor must be “the national of another Contracting State as defined in paragraph (2) of Article 25 of the Convention”.¹⁰² In other

¹⁰⁰ Article 2(I)(1) of the Statute Governing the ICSID Convention: “The term ‘government of the Republic of China’ means the central government of the Republic of China.”

¹⁰¹ See Article 25(1) of the ICSID Convention: “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of any investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by the State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.”

¹⁰² In accordance with Article 25(2) of the ICSID Convention: “‘National of another Contracting State’ means

words, to qualify as a “foreign investor” under the Statute Governing the ICSID Convention, the investor must not, in principle, have ROC nationality. As discussed in Chapter 10, most overseas Chinese have dual nationality and under general international law, a dual national (of a foreign country and the host state) is considered a national of the host state. This may seem to answer the question raised earlier as to why overseas Chinese investments are excluded under the present Statute Governing the ICSID Convention. However, there are some ethnic Chinese who do not have ROC nationality but who invest in Taiwan under the SIOC. Since those ethnic Chinese are qualified to be parties under the ICSID Convention (because they do not have ROC nationality), it is not clear why the ROC municipal law should exclude them: It was stated earlier that the substantive provisions are almost identical in the SIFN and SIOC; but if the Government’s motive for distinguishing between these two categories is to give symbolic recognition to the special status of ‘overseas Chinese’, it seems very odd to disadvantage them by precluding access.

(c) Requirement of Consent

Consent to resort to ICSID is granted by the Ministry of Economic Affairs (MOEA) of the ROC (Article 3). To request consent the foreign investor who is a party to a dispute must meet the conditions set out above. In addition, Article 4 (I) of the Statute Governing the ICSID Convention requires that:

-
- (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and
 - (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.”

“4. The amount of the capital for the investment in connection with the dispute imported into the territory of the Republic of China exceeds one hundred thousand United States dollars (US\$ 100,000).

5. The dispute has arisen after this Statute has become effective.

6. The foreign investor who is a party to the dispute has not resorted to an administrative or judicial remedy in connection with the dispute within the territory of the Republic of China”

The availability of local remedies is optional under the Statute Governing the ICSID Convention. Assuming that the investor looks for local remedies, a relevant question is whether the foreign investor is then prejudiced in his right to bring an action in an ROC court. Article 2 of the Law Governing the Application of the General Principles of the Civil Code provides that, “within the limits prescribed by law or ordinances, a foreigner has the capacity to enjoy rights”. As “whoever has capacity to enjoy rights has the capacity to be a party to an action” (Article 40 of the Code of Civil Procedure¹⁰³), it is clear that the rights of a foreign investor to sue will be respected. Similarly a “recognised”¹⁰⁴ foreign company has the same capacity to enjoy rights as an ROC company.¹⁰⁵ However, can a ‘non-recognised’ foreign company be a party to legal action? Although the law does not say much about a ‘non-recognised’ foreign company’s right to be a party to legal action, a 1961 Supreme Court ruling has affirmed that even a ‘non-recognised’ foreign company may be a party to civil action.¹⁰⁶ It therefore seems clear that, so far as a

¹⁰³ Promulgated on December 26, 1930; the last amendment was on August 20, 1990.

¹⁰⁴ Article 371 (II) of the Company Law states: “A foreign company shall not transact business within the territory of the Republic of China without a certificate of authority given after admission, and cannot apply for admission without incorporation in its own country.”

¹⁰⁵ Article 12 of the Law Governing the Application of the General Principles of the Civil Code reads: “Within the limits prescribed by law and ordinances, a recognised juridical person has the same capacity of enjoying rights as a ROC juridical person.”

¹⁰⁶ The ROC Supreme Court rules as follows: “Although a foreign person not ‘recognised’ by ROC authority is not deemed a juridical person under the ROC law, it is nevertheless a non-juridical person organised under para. 3 of Article 40 of the Code of Civil Procedure. In other words, as long as it has a representative or administrator, a non-juridical person or organisation may be a plaintiff or defendant in the ROC Court. Whether the foreign juridical person has an office or business in the ROC is not relevant for this purpose.” Decision with reference number of T’ai-shang-tzu 1898 (1961).

civil action is concerned, the rights of a foreign litigant are equal to those of ROC nationals and companies, and that a foreign litigant may not be prejudiced (Hsu *et al.*, 1985: 579-580).

However, the situation is less clear where a foreign investor has resorted to the administrative or judicial authorities for a remedy, but has been turned down improperly even according to the laws of the ROC. Would consent be given if the investor requested it? Similarly in the case where, although compensation was being offered by such authorities, it was manifestly inadequate under international law; could the investor seek consent to go to ICSID? The answer to those questions seem to be negative. Inevitably, this will lead to a return to the principle of diplomatic protection.

Upon the request of the foreign investor for consent to submit the dispute to ICSID, the MOEA shall decide such a request, if the investor meets the foregoing conditions, "in accordance with the actual circumstances".¹⁰⁷ Vexatious or frivolous cases are practically impossible after double screening by the MOEA and the Secretary-General of ICSID.¹⁰⁸ The approval or disapproval of the request shall be made in writing.¹⁰⁹

¹⁰⁷ Article 4(II)(2) of the Statute Governing the ICSID Convention provides: "The approval or disapproval of the request which is in conformity with the conditions set forth in the preceding paragraph shall be decided in accordance with the actual circumstances."

¹⁰⁸ Article 28(3) of the ICSID Convention states: "The Secretary-General shall register the request unless he finds, on the basis of the information contained in the request, that the dispute is manifestly outside the jurisdiction of the Centre. He shall forthwith notify the parties of registration or refusal to register."

¹⁰⁹ Article 4(II) provides: "Upon the request of the foreign investor for a consent to submit the dispute to the Centre for conciliation or arbitration, the Ministry of Economic Affairs shall decide in writing whether such request shall be dismissed, or shall be approved or disapproved."

In the case of an investment exceeding two million five hundred thousand United States dollars (US\$ 2,500,000), or of an investment making an important contribution to the ROC economy and which exceeds four hundred thousand United States dollars (US\$ 400,000), the investor may obtain an advance consent from the MOEA to take any future disputes arising out of its investment before the ICSID for settlement, in writing at the time of approval of the investment.¹¹⁰

If the MOEA gives its consent to submit a dispute which is in violation of Article 4 (I) of the Statute Governing the ICSID Convention, the consent is deemed to be null and void *ab initio*.¹¹¹ Supposing that an investor, on the basis of such consent given by the MOEA, resorts to ICSID and satisfies the Secretary-General.¹¹² Since the consent cannot be withdrawn unilaterally, what would be the consequence?

Obviously, the purpose of Article 5 of the Statute Governing the ICSID Convention is to increase the rigidity of the jurisdiction of the ICSID. However, here the subject-matter is not concerned with a non-existent legal right, but rather with the *ultra vires* decision of an administrative organ of the State: in other words, a dispute concerning the *compromis* of the ICSID. Taking reality or 'universal experience' into consideration, the absolute nullity of the consent must be recognised, although "in fact, to say that action outside the limits expressed by the rule is a nullity seems to be no more than another way of expressing the rule itself" (Jennings, 1965: 81). The attack on jurisdiction would need to be launched before

¹¹⁰ Article 4 (III) of the Statute Governing the Convention.

¹¹¹ Article 5 of the Statute Governing the Convention.

¹¹² The Secretary-General is the legal representative and the principal officer of the ICSID (Article 11 of the Convention). If the Secretary-General finds that the dispute is manifestly outside the jurisdiction of the ICSID, he "shall forthwith notify the parties of registration or refusal to register" (Article 28 and 36 of the ICSID Convention).

the Commission (for conciliation) or Tribunal (for arbitration), as the case may be, in the form of a preliminary objection. This is because it is up to the discretion of the Commission or the Tribunal to decide “whether to deal with it as a preliminary question or to join it to the merits of the dispute” according to Article 32(2) and 41(2) of the ICSID Convention respectively; the rejection of the report, in the case of conciliation, and the annulment of the award, in the case of arbitration (Article 52 of the ICSID Convention), must necessarily follow from this.

(ii) The Applicable Law

Article 7 (I) of the Statute Governing the ICSID Convention provides that:

“The Ministry of Economic Affairs shall not, in negotiating with the other party to the dispute in connection with the applicable law or laws for the settlement of the dispute pursuant to the provisions of paragraph (1) of Article 42 of the Convention, agree to apply any law or laws other than that of the Republic of China”

In case the above provision is violated, “it shall be deemed that no agreement in connection with the applicable law or laws has been reached”.¹¹³ In such circumstances, the Tribunal is bound to apply the provision of Article 42 (1) of the ICSID Convention.

(iii) Enforcement of the Award

Treaties, being regarded as equivalent to the ROC’s municipal laws (see Chapter 11.1 above), can be applied by courts. Foreign awards, rendered pursuant to the provisions of a treaty, may also be enforced by ROC courts, provided that they satisfy certain requirements which we shall discuss presently. According to Article 30 of the Statute for Commercial Arbitration,¹¹⁴ foreign awards can be

¹¹³ Article 7(II) of the Statute Governing the ICSID Convention states: “In case the Ministry of Economic Affairs gives its consent in violation of the provisions of the preceding paragraph, it shall be deemed that no agreement in connection with the applicable law or laws has been reached.”

¹¹⁴ Promulgated on January 20, 1961; Amended on June 11, 1982 and December 26, 1986.

enforced after they have obtained recognition from an ROC court.¹¹⁵ Indeed, the arbitral awards rendered pursuant to the ICSID Convention will be enforced automatically by the ROC courts.¹¹⁶ The relevant court under Article 1 of the Compulsory Execution Law¹¹⁷ is the District Court. Article 43 of the Compulsory Execution Law reads:

“With respect to an application for compulsory execution filed in reliance upon a final judgement of a foreign court, execution may be carried out only when judgement of the foreign court is not made in any of the events as prescribed in various items of Article 402 of the Code of Civil Procedure and a permission for such execution has been pronounced by a ROC court by virtue of a judgement.”

Article 402(III) provides for the situation where “the judgement of the foreign court is considered to be incompatible with public order or good morals”. It is doubtful whether the award rendered by the Tribunal must be enforced if it violates the public policy of the ROC. On the other hand, if a foreign award contradicts a precedent made by an ROC court, it may be that the award would be recognised. On these matters, the enforcement provisions in the ROC laws do not offer much help. Speculative as it would be to do so, no attempt is made here to predict future enforcement in such circumstances.

(B) Bilateral Investment Treaties

As noted above, states have been reluctant to enter into bilateral investment treaties with Taiwan, mainly because of the widespread non-recognition of Taiwan

¹¹⁵ The Statute for Commercial Arbitration uses the *situs* of an award to determine whether the arbitral award is foreign or domestic. Article 30 (I) defines a “foreign arbitral award” as an “arbitration award rendered by any arbitral tribunals sitting outside the territory of the Republic of China”. For further discussion, see Lee (1987: 138), Chen (1992: 13-21), and Chang (1988: 18). There have been roughly 20 cases concerning recognition of foreign arbitral awards in Taiwan (Lin, 1993: 79).

¹¹⁶ Article 8 of the Statute Governing the ICSID Convention: “All or part of the arbitral award rendered pursuant to the Convention requiring enforcement by the domestic court shall be referred to the court for compulsory execution.”

¹¹⁷ Promulgated on January 19, 1940; amended on May 16, 1945, December 21, 1948, and April 22, 1975.

and the fear that entry into a bilateral treaty with Taiwan would harm a country's relationship with mainland China. Taiwan has only concluded 10 bilateral investment treaties with other countries at the time of writing.

It is interesting to find that there are only slight differences between individual bilateral investment treaties regarding dispute settlement in Taiwan. For settlement of disputes between the Contracting Parties, most treaties provide that the disputes should be settled "amicably" through "negotiations" or "consultations". If the dispute cannot be settled within 6 months, it should be referred to an arbitral tribunal on "terms and conditions as the contracting Parties may agree". A similar standard applies for disputes between Contracting Parties and individual investors.

The common provision that, under certain circumstances the dispute can be referred to ICSID, which is found in many bilateral investment treaties,¹¹⁸ is not found in any of the ROC bilateral treaties. Once again, this is the consequence of the legal status of Taiwan. The ROC was a Contracting State to the ICSID Convention, and ratified the ICSID Convention through its municipal procedures; thus, theoretically, the ROC is a Member of ICSID. However, after the ROC withdrew from the UN in 1971, it was excluded from all international organisations related to the UN, including the World Bank. ICSID was established by the ICSID Convention of 1965, which was in turn adopted under the auspices of the World Bank. Although it has a juridical personality of its own,¹¹⁹ ICSID is structurally linked with the Bank.¹²⁰ This relationship between the Bank and ICSID is explained

¹¹⁸ For instance, see, Article 8 (1) of the UK-Hungary Investment Treaty and Article 6 (3) (b) of the UK-Turkey Investment Treaty.

¹¹⁹ Article 18 of the ICSID Convention states: "The Centre shall have full international legal personality."

¹²⁰ Article 2 of the ICSID Convention provides: "The seat of the Centre shall be at the principal office of the International Bank for Reconstruction and Development."

in Article 67 of the ICSID Convention, which stipulates that any State is eligible to be a party if it is a member of the World Bank.¹²¹ Thus, although the Statute Governing the ICSID Convention remains valid, technically it appears that the ROC is not eligible for membership of ICSID after 1971. This is also the reason why there is no provision in any ROC bilateral investment treaties regarding ICSID. Fortunately, to date, in all cases involving the ROC, investment disputes have been resolved at an early stage by diplomatic means or by amicable negotiations. However, it seems clear that the ROC government will have in future to make its own luck. It must continue, on its own initiative, to create a favourable investment environment through imaginative economic policies and legal instruments in order to facilitate its ongoing economic growth. Only with a strong economy can the ROC continue to survive in a politically hostile world.

¹²¹ In addition, any State party to the Statute of the International Court of Justice will be eligible to sign the ICSID Convention and be a party to the Centre if it is invited thereto by two-thirds of the Administrative Council (Article 67 of the ICSID Convention).

Chapter 12

Conclusions

12.1 An Assessment of the Interaction between Law, FDI and Economic Development

This research, based upon an empirical study, has demonstrated how the development experience of Taiwan challenges the traditional views of development theory and of law and development theory. In addition, the analysis has shown the dynamic interaction of law, FDI and economic development in Taiwan's development process, confirming the propositions which I put forward in Chapter 1:

1. FDI can facilitate economic development only if the appropriate laws are adopted.
2. As FDI facilitates economic development, and the level of economic development changes, the Government responds with new laws or legal reforms in order to encourage further economic development. The content of these laws is shaped by the levels of economic development.
3. The restrictions and incentives provided for by law (and by legal reforms) affect the performance of FDI. Consequently, the performance of FDI affects the performance of a country's economic development.
4. In the case of Taiwan, appropriate liberalisation of the law leads to more inflows of FDI, which leads to further successful economic development.

Taiwan's history and geographic location has affected its political and constitutional status, which in turn have also determined its early economic

development. The various political changes illustrate the complexity of Taiwan's development history: the Dutch, the Cheng regime, the Ch'ing dynasty and Japanese colonisation represent periods embracing different cultures, languages, and ethnic groups. The economic policies adopted by these different rulers reflect their different political and economic interests in Taiwan. In particular, Japanese colonial economic policy has had an important impact on Taiwan's later development. With no intention of helping Taiwan's development, the Japanese strategy was a typical colonial one - to exploit Taiwan's economic resources for Japan's benefit. However, in order to achieve this aim, the Japanese necessarily improved Taiwan's agriculture and agriculture-related industrial development. In addition, while preparing for war, the Japanese invested in heavy industries in the 1930s and thus benefited Taiwan's industrial sector.

After the civil war, the KMT government moved to Taiwan from the mainland in 1949. As was stated in Part II, Taiwan's new Government was implanted from the mainland and did not represent the political expression of domestic economic or social relations. The Government reshaped and dominated social forces, removing politics from society's agenda, but at the same time providing numerous other channels for mobility and status. It subordinated the political environment for the purpose of economic development, and for almost four decades did not allow emerging economic interests to influence social relations through the political process. While the Government concentrated on Taiwan's economic development, its visible economic success helped dampen potential political disaffection.

This process occurred in stages. The Government's ideological commitment to social equality and the absence of entrenched connections between the Government and local businessman first led to the successful land reforms of the early 1950s, helping to ensure a wider level of participation in economic activity and wealth. In turn, this would lay down a basis for later economic development. At

the same time, US aid stabilised post-war inflation and, more importantly, provided psychological support for the Taiwanese people. Once its political status stabilised, the Government could then endeavour to improve Taiwan's economic situation.

Never taking a *laissez-faire* approach, the Government has played a very active role in Taiwan's economic development. Regularly re-evaluating Taiwan's economic performance as a whole, the Government has adopted various economic policies to stimulate and to reshape Taiwan's economic growth. Import-substitution, export-substitution, secondary import and export substitution and industrial upgrading represent stages in the Government's response to evolving internal and international economic factors. Additionally, based upon the notion of using foreign capital to help national development, in accordance with the *Min-sheng* philosophy, the Government has a positive attitude towards FDI. At a general level, its macroeconomic policies have created an advantageous macroeconomic environment for foreign investors to invest in Taiwan.¹ More specifically, the FDI policy refined the macroeconomic policy and provided incentives to selective strategic industries for foreign investment. Simultaneously, the Government has constantly monitored and reformed Taiwan's FDI laws to maintain a balance between incentives to attract FDI and restrictions to control it. This study demonstrates that Taiwan's FDI laws have gradually been liberalised in the development process. The FDI inflows have also gradually increased, consistent with the legal liberalisation. The increase of FDI inflows neither decreased Taiwan's economic growth rate, nor worsened Taiwan's economic performance. Conversely, various economic indicators show that Taiwan is now moving towards becoming a matured economic entity.

¹ Most economists today accept the argument that a stable and predictable macroeconomic environment arising from political stability and prudent macroeconomic policies is most important in attracting FDI (Chen, 1993: 57).

More recently, economic liberalisation created pressures for political liberalisation. The Government lifted martial law in 1987 and held the first popularly-elected presidential election in 1996. With political liberalisation, the macroeconomic environment in Taiwan has experienced significant change. The Government has speeded up the pace for economic liberalisation and privatisation, thus providing FDI with more opportunity to invest in Taiwan. Indeed, in the latest survey by the US-based Business Environment Risk Information Company, Taiwan and Japan ranked as the third highest business investment profit-return in the world, slightly behind Switzerland and Singapore (*CDN*, August 9, 1997).

History shows that major social reforms have always encountered resistance, as they tend to undercut the entrenched interests of existing influential groups. More often than not, violent confrontations have accompanied sweeping reforms, as was demonstrated in recent years with the changes occurring in the ex-Soviet republics and the former communist states of Eastern Europe. Why did this not happen in Taiwan during its various economic reforms? There are two key criteria for evaluating whether major social reform initiatives will succeed in promoting the overall well-being of a given society. The first is the goals of the reforms themselves, and the second involves the process by which they are introduced. Because the KMT government was implanted from the mainland, it did not have connections with local entrepreneurs. Consequently, its economic reforms were targeted at benefiting the entire citizenry and not the interests of any particular political party or social subgroup. Secondly, the method by which economic reform was introduced by the Government has always been mild rather than radical. Finally, its national economic success - in achieving growth with equality - is the most important reason that decreases the possibility for class conflicts.

The traditional *dependentistas* have argued that the MNEs' capital-intensive technology excludes a large portion of the working class from the modern sector, and that only an elite segment of the bourgeoisie can profit from the MNEs. MNEs'

dependence on imported materials prevents the development of linkages with domestic suppliers and fabricators. The goods produced by the MNEs are designed for core country consumers, and thus promote a wealthy class divorced from local production and tastes (Evan, 1979: 38).

Taiwan has not experienced these adverse effects from MNE penetration. Nor has it experienced an increasing dependence on foreign resources, or unemployment or underemployment in the manner which many Latin American countries have experienced. Why? It seems that the crucial factor explaining such differences is not so much the national origin and types of MNEs that have gone to the developing countries. Rather, such differences are mainly explained by the different development strategies and varying domestic economic environments of the host countries.

In Chapter 6, we saw that the choice of development strategy, whether export substitution or import substitution, seems to be crucial in this regard. A country adopting an export substitution strategy has a less-protected domestic economic environment, so that FDI is forced to use resources in a more appropriate way to maintain a high degree of international competitiveness. Taiwan's experience of competition under an export-oriented environment is important in explaining the choice of technology by MNE affiliates. The closed and monopolistic nature of the economic environment prevailing under an import-substitution regime gives foreign investors little incentive to adapt foreign technology to local conditions and to achieve maximum efficiency. The choice of adopting an export-substitution strategy was crucial in ensuring continued growth of Taiwan's economic performance. The case of Taiwan illustrates the potential of a well-integrated and committed developing state, with competent human resources, to seek out opportunities within the world system and to successfully mediate between domestic and global forces to attain maximum benefit.

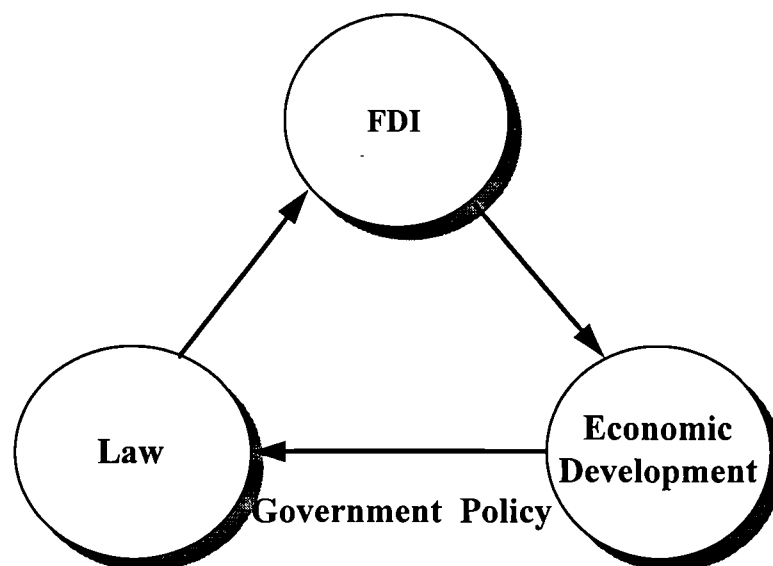
In terms of the role of law in Taiwan's economic development, the evidence in this thesis suggests that law is effectively used in Taiwan as an instrument to facilitate the implementation of the Government's policies. Because the goals of economic policy have been to improve national and individual wealth, this in principle excludes the possibility for law to serve only the rich and powerful. The legal regime in Taiwan is designed ideally to ensure appropriate commercial and labour relations, to maintain a fair and sound social operation, to allow fair competition for both domestic and foreign investors, to provide a mechanism to meet the needs of existing development policy, and to ensure a favourable environment for further development. Taiwan's success suggests that those ideals have not been beyond reach.

Although Taiwan has a welcoming policy towards FDI, we have seen that in order to protect domestic enterprises and preserve the national control of some sectors, the Government has used state regulation to closely control the activity of FDI. Taiwan's experience illustrates the moderate theory of foreign investment which I introduced in Chapter 1. However, it is important to note that, with Taiwan's modern economic growth, the Government has liberalised the law. With legal liberalisation, State intervention in FDI has been significantly reduced. What does this imply? Does it mean that the role of law is not as important as it used to be? The answer is no. As Part III demonstrates, the role of law remains no less important even as a country emerges from its development phase. This study suggests that an *appropriate* legal regime is a 'doorkeeper' for preventing MNEs from exploiting a host country's economic resources through FDI. The 'appropriateness' of such a regime should be carefully evaluated, and re-evaluated, by the government in accordance with the country's economic performance and changing needs. Even in developed countries, regulations regarding the admission of FDI are still very common. Without the constraint of law, not only would a country not be able to benefit efficiently from FDI, but it would also be likely to

suffer from the adverse effects of FDI. In the worst case, a country might lose control of its economy. This research suggests that developing countries should carefully evaluate their economic performance on a continual basis and carefully adjust their legal regime accordingly, in order to shape their investment environment for the benefit of national development.

Finally, since Government policy has played such an important part in shaping and reshaping Taiwan's economic development, it may be appropriate to reflect this by slightly modifying as follows the model which I proposed in Chapter 1:

Figure 12.1 Foreign Direct Investment: Legal and Economic Interaction Model



By emphasising the importance of government policy, this revised model offers a more informative explanation of the interaction between law, FDI, and economic development in Taiwan.

12.2 Where Should Taiwan Go? Taiwan's Future FDI Law Reforms

Foreign investors in Taiwan are regulated by FDI laws and treaties. However, the current FDI legal regime in Taiwan, as analysed in this thesis, is not an unproblematic one. In considering the existing regime, I have noted a number of possibilities for legal reform which I will not repeat here. Nevertheless, at a policy level, further legal reform in the future may be expected to facilitate Taiwan's continued economic development.

From the point of view of international law, the most effective instruments for the protection of foreign investment are bilateral treaties which reaffirm the rules of customary international law. However, Taiwan's political status has limited the opportunities for concluding such treaties with other countries. None of the major investors in Taiwan, such as Japan, the US and the West European countries, have concluded bilateral investment treaties with Taiwan. Certainly, Taiwan should not take the blame for its failure to ensure protection for foreign investments by this means.

As noted in Chapter 8, the Government has begun to liberalise its economic control since 1984. In recent years, political liberalisation has also necessitated a more liberal economic policy. Correspondingly, in the context of FDI, the Government has sought to widen Taiwan's investment fields and capital-flow channels for foreigners and for overseas Chinese. A further proposal to substantially ease restrictions on foreign investment was approved by the ROC

Executive Yüan on January 26, 1997 and has gone to the Legislative Yüan for review. Because of the well-known inefficiency of that body, it is expected that the review process will take some time.

In the above-mentioned proposal, investment in certain public facilities currently off-limits to foreign concerns - such as oil refining, power generation, tap water supply, ports and railways - is to be permitted on a case-by-case basis. Selective consideration will also be given to overseas investors who wish to invest in pollution-prone industries like asbestos, coal refining, and monosodium glutamate, as well as in lethal chemicals like sodium cyanide and potassium cyanide. The draft law calls for a complete freeing-up of investment in businesses like gas stations, travel agencies, animal feed factories, leather production and the making of chemical fertilisers. Currently, these areas are barred to foreign investment. Current regulations require foreign investors in Taiwan to wait at least one year before remitting profits out of the island. The proposed amendment abolishes this requirement.

Moreover, companies with less than 20 per cent foreign or overseas Chinese capital will have absolute freedom to make reinvestments in other fields. They will no longer need prior government approval for such activities. Foreign and overseas Chinese investors will also be allowed to use the New Taiwan dollar, instead of foreign currencies, to make payments on investment projects in Taiwan. By bringing investment regulations in line with international trends, Taiwan will be better-positioned to participate in international organisations, including WTO.²

In the future, it seems that only a few industrial sectors will remain off-limits to foreign investment. Mainly, these will include areas where outside

² As explained in Chapter 8, the ROC has applied to join WTO by using "The Separated Customs Territory of Taiwan, Penghu, Kinmen and Matsu" for its application. Taiwan has now completed 20 bilateral talks with the Member States of WTO for full support of the ROC's membership (*CDN*, July 23, 1997), and 13 countries have signed bilateral agreements with Taiwan (*CDN*, May 10, 1997).

participation could threaten national security, public order, social mores or national health. Due to limited resources, foreign investors will continue to be prohibited from purchasing land in Taiwan. However, they can engage in real estate marketing and construction projects after gaining the Economics Ministry's approval. In an administrative streamlining measure, the draft amendment designates the Economics Ministry's Investment Commission as the agency responsible for screening foreign investment applications. The commission is also made responsible for screening foreign firms' applications to set up branches in Taiwan. These various revisions are in tandem with the government's overall effort to liberalise and internationalise Taiwan's markets. The changes will, it is hoped, encourage MNEs to establish their Asian-Pacific operations headquarters on the island (*FCJ*, February 10, 1997).

It is obvious that these draft laws represent a significant further liberalisation of Taiwan's FDI legal regime for the future. Some of the reforms are consistent with suggestions I made when analysing Taiwan's FDI laws in Part III; others are not. For example, the draft laws call for abolishing the one-year lock-up period for repatriation of profits, but still do not give a working definition of either "FDI" or "foreigners".

Furthermore, there is an important consideration mentioned in this thesis that is not sufficiently reflected in the draft laws - increased efficiency in the legislative and administrative system. According to a survey, released on May 17, 1997 by the Switzerland-based International Institute for Management and Development, the Taiwan government's efficiency is ranked 20th among the 46 countries and territories surveyed, which is down from sixth place in the 1996 survey (*CDN*, May 20, 1997; *FCJ*, May 23, 1997). It is questionable whether there is a need for Taiwan to have two different FDI regimes, under the Statute for Investment by Overseas Chinese and the Statute for Investment by Foreign Nationals, which certainly contributes to bureaucratic inefficiency.

In the context of a different political and economic environment 40 years ago, it is not surprising that the Government afforded preferential incentives to overseas Chinese investors rather than foreign nationals. They were intended to attract more overseas Chinese to invest in Taiwan, in order to advance Taiwan's claim of speaking for China. The overseas Chinese were an object of aggressive propaganda by both the Taipei and the Peking regimes, which desired their loyalty and financial support as well as the benefits of investors' influence within their home states. However, 40 years later, the FDI laws discriminating between overseas Chinese and foreign nationals have not only slowed down the legislative process but have also increased administrative inefficiency. The distinction needs to be re-evaluated by the Government.

If this is done, however, the re-evaluation will not be the last. Like time, societies and their economies do not stand still. As they evolve, so too the economic and developmental needs of Taiwan will change. And the law, if it is to facilitate and control the FDI that best satisfies those needs, must constantly grow and adapt with them.

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